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THROWING THE E-BOOK AT PUBLISHERS: WHAT THE APPLE CASE TELLS US ABOUT ANTITRUST LAW

*Jared Killeen**

INTRODUCTION

On November 19, 2007, amid much buzz and speculation, Amazon—the eminent online retailer—released its first Kindle e-reader device.¹ Less than eight inches in length, and weighing 10.3 ounces,² the Kindle contained only a small screen and various alphanumeric buttons.³ According to commentators, however, Amazon’s little device “revolutionized” the publishing industry⁴

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¹ RICHARD L. BRANDT, ONE CLICK: JEFF BEZOS AND THE RISE OF AMAZON.COM 139 (2011); *see also* Ryan Block, *Live from the Amazon Kindle Launch Event*, ENGADGET (Nov. 19, 2007, 9:23 AM), <http://www.engadget.com/2007/11/19/live-from-the-amazon-kindle-launch-event/>; Jack Schofield, *Amazon Will Launch Kindle e-Book Reader on Monday*, GUARDIAN TECH. BLOG (Nov. 18, 2007, 3:33 PM), <http://www.guardian.co.uk/technology/blog/2007/nov/18/amazonwilllaunchkindleeboo>.

² *Amazon Kindle 1st-gen*, ENGADGET, <http://www.engadget.com/products/amazon/kindle/1st-gen/specs/> (last visited Nov. 19, 2013).

³ The Kindle is an electronic reader (“e-reader”), a device on which consumers may purchase and read electronic books (“e-books”). E-books are like print books, but published in an electronic format. They are easily downloaded through retailer Web sites or applications on mobile devices. *See* Complaint at 2, *United States v. Apple, Inc.*, 889 F. Supp. 2d 623 (S.D.N.Y. 2012) (No. 12 Civ. 2826), 2012 WL 1193205.

⁴ *See, e.g.*, RYAN DEISS, *KINDLE PUBLISHING REVOLUTION* (2012), *available at* <http://www.amazon.com/Kindle-Publishing-Revolution-Amazon->

and created a burgeoning e-book market.⁵ The success of the e-book revolution arose from the Kindle's unique electronic-ink display⁶ and wireless connectivity.⁷ Instead of purchasing a physical book from a bookshop, or borrowing one from a library, users could now connect directly to Amazon and, within seconds, download an e-book from a vast selection of electronic files.⁸ Perhaps most appealing to consumers, however, was the "cut-rate" price of Amazon e-books.⁹ Despite protests from book publishers, Amazon sold new releases for only \$9.99,¹⁰ well below production

ebook/dp/B008ZRGSY2; Matt Warman, *Amazon's New Kindle and a Readers' Revolution*, TELEGRAPH (Oct. 15, 2011, 7:00 AM), <http://www.telegraph.co.uk/technology/amazon/8827796/Amazons-new-Kindle-and-a-readers-revolution.html>; Steve Windwalker, *Just How Big Is the Kindle Revolution?*, SEEKING ALPHA (Jan. 14, 2011, 7:45 PM), <http://seekingalpha.com/article/246700-just-how-big-is-the-kindle-revolution>.

⁵ Within six months of launching the Kindle, Amazon had sold one hundred thousand units. By 2011, the company had sold well over twenty million units. See Windwalker, *supra* note 4. More astoundingly, by 2010, Amazon e-books comprised up to twenty percent of sales for major book publishers. BRANDT, *supra* note 1, at 142.

⁶ See BRANDT, *supra* note 1, at 140. The Kindle display, unlike computer screens and earlier e-reader devices, used electronic ink ("e-ink"). The e-ink display contained millions of "microcapsules" that formed a pleasant white background over which darker text appeared. *Id.* at 140–41. Consumers found e-ink easier to read for long periods of time than the text on standard computer screens. *Id.*

⁷ The Kindle connected to the Internet via a system called Whispernet. Schofield, *supra* note 1. Connectivity allowed users not only to download e-books in a matter of seconds, but also to subscribe to newspapers and magazines. *Id.* As a result, Amazon Chief Executive Officer Jeff Bezos has stated that the Kindle isn't merely "a device, it's a service." *Id.*

⁸ BRANDT, *supra* note 1, at 140. Before Amazon released the Kindle, most e-readers were clunky and expensive, offering only a small selection of downloadable titles. *Id.* at 137–41. Because Amazon began as an online "bookstore," however, the company had existing contracts with large book publishers and was able to offer ninety thousand titles upon the Kindle's release in 2007. *Id.* at 141.

⁹ *Id.* at 142.

¹⁰ *Id.* See also Competitive Impact Statement at 3, *United States v. Apple, Inc.*, 889 F. Supp. 2d 623 (S.D.N.Y. 2012) (No. 12 Civ. 2826), 2012 WL 1193207; Sarah Lacy, *Confessions of a Publisher: "We're in Amazon's Sights*

cost.¹¹

Amazon quickly turned the e-book revolution into a coup. The company's willingness to lose money on e-book sales¹² rendered the market unattractive to competitors, which uniformly declined to participate in a costly price war.¹³ Thus, by 2012, with a ninety-percent share of the e-book market,¹⁴ Amazon had established an effective monopoly.¹⁵ Amazon used its new-found dominance to force the "Big Six" New York book publishers ("publishers")¹⁶

and *They're Going to Kill Us*," PANDODAILY (Jan. 17, 2012), <http://pandodaily.com/2012/01/17/confessions-of-a-publisher-were-in-amazons-sights-and-theyre-going-to-kill-us/>.

¹¹ Brief of Bob Kohn as Amicus Curiae at 22, *United States v. Apple, Inc.*, 889 F. Supp. 2d 623 (S.D.N.Y. 2012) (No. 12 Civ. 2826).

¹² See Rory Maher, *Here's Why Amazon Will Win The e-Book War: Kindle Already Has 90% e-Book Share*, BUS. INSIDER (Jan. 13, 2010, 12:38 PM), <http://www.businessinsider.com/amazon-selling-90-of-all-e-books-2010-1> (estimating from American Association of Book Publishers' data that Amazon lost \$35 million on e-book sales through October 2009); see also Brief of Bob Kohn, *supra* note 11, at 20–21; BRANDT, *supra* note 1, at 142.

¹³ By selling e-books at a loss, Amazon wished to keep competitors "from getting a foothold on the virtual bookshelf." BRANDT, *supra* note 1, at 142–43. The strategy clearly worked. For years, Amazon's predatory pricing deterred competitors like Apple, Google, Barnes & Noble, and Zola Books from entering the e-book market. See *United States v. Apple, Inc.*, 889 F. Supp. 2d 623, 640 (S.D.N.Y. 2012).

¹⁴ See, e.g., Comments of Barnes & Noble, Inc. on the Proposed Final Judgment at 9, *United States v. Apple, Inc.*, 889 F. Supp. 2d 623 (S.D.N.Y. 2012) (No. 12 Civ. 2826); Michael Hiltzick, *Government's e-Book Case Helps Amazon Build Toward a Monopoly*, L.A. TIMES (Sept. 12, 2012), <http://articles.latimes.com/2012/sep/12/business/la-fi-hiltzik-20120912>; Maher, *supra* note 12; Matt Phillips, *Amazon e-Book Share to Fall from 90% to 35%, Analysts Say*, WSJ MARKETBEAT (Feb. 16, 2010, 10:59 AM), <http://blogs.wsj.com/marketbeat/2010/02/16/analyst-amazon-e-book-share-to-fall-from-90-to-35/>.

¹⁵ See, e.g., Stacy Mitchell, *Justice Department Abets Amazon's e-Book Monopoly*, INST. LOCAL SELF-RELIANCE (June 20, 2012), <http://www.ilsr.org/dojs-lawsuit/>.

¹⁶ The so-called "Big Six" include Hachette, Harper Collins, Macmillan, Penguin, Random House, and Simon & Schuster. *Get Published!: Who Are the Big Six Publishers?*, PRITCHETT, FARLOW, & SMITH PUBLISHERS (Mar. 1, 2011, 1:39 PM), <http://www.pfspublishing.com/workshop/2011/03/get-published-who-are-the-big-six.html>. However, the publishers do not appear all that "big"

into continuing to sell e-books cheaply, inspiring concern that consumers would become accustomed to untenably low prices.¹⁷ Moreover, Amazon's predatory tactics created inefficiency in the e-book market by spurring overconsumption of e-books at artificially low prices. These tactics skewed the e-book demand curve¹⁸ and threatened the welfare of consumers who, under Amazon's monopoly, would not enjoy the benefits of healthy price and product competition in the e-book market.¹⁹ Government regulators, however, did nothing.²⁰

In 2009, book publishers took action to curb Amazon's

alongside retail behemoth Amazon, whose 2011 sales topped \$48.08 billion. See Donald Melanson, *Amazon Announces 2011 Q4 Results: Sales Jump to \$17.43 billion, but Profits Drop 58 percent*, ENGADGET (Jan. 31, 2012, 4:26 PM), <http://www.engadget.com/2012/01/31/amazon-announces-q4-2011-results-sales-jump-to-17-43-billion/>. In comparison, the combined revenue of all six book publishers barely topped \$10 billion in 2011. Penguin sales totaled \$1.71 billion. See *Penguin Sales Rise 26% on 6% Sales Gains*, PUBLISHERS WEEKLY (Feb. 28, 2011), <http://www.publishersweekly.com/pw/by-topic/industry-news/financial-reporting/article/46323-penguin-has-record-2010.html>. Hachette sales totaled \$2.64 billion; Random House sales totaled \$2.57 billion; Macmillan sales totaled \$1.9 billion; Harper Collins sales totaled \$1.1 billion; and Simon & Schuster sales totaled \$787 million. See *The Global 50: The World's Largest Book Publishers, 2012*, PUBLISHERS WEEKLY (June 25, 2012), <http://www.publishersweekly.com/pw/by-topic/industry-news/financial-reporting/article/52677-the-world-s-54-largest-book-publishers-2012.html>.

¹⁷ For instance, when Macmillan refused to abide by Amazon's pricing model, the latter removed MacMillan's books from its Web site. See BRANDT, *supra* note 1, at 143. See also Christopher Matthews, *Should Justice Drop the Apple Ebook Lawsuit?*, TIME (July 23, 2012), <http://business.time.com/2012/07/23/should-justice-drop-the-apple-ebook-lawsuit/> (observing that the shift to an agency model was an effort by publishers to prevent Amazon from setting its prices too low); Competitive Impact Statement, *supra* note 10, at 4; Complaint, *supra* note 3, at 2.

¹⁸ See Christopher R. Leslie, Comment, *Achieving Efficiency Through Collusion: A Market Failure Defense to Horizontal Price-Fixing*, 81 CALIF. L. REV. 243 (1993) (arguing that horizontal price-fixing can help markets function more efficiently by ensuring that supply does not grossly exceed demand).

¹⁹ See Comments of Barnes & Noble, Inc. on the Proposed Final Judgment at 10, *United States v. Apple, Inc.*, 889 F. Supp. 2d 623 (S.D.N.Y. 2012) (No. 12 Civ. 2826).

²⁰ See Mitchell, *supra* note 15.

stranglehold on the e-book market. They devised a plan with technology company Apple to stop Amazon's predatory pricing.²¹ At the same time Amazon enjoyed an e-book monopoly, Apple was preparing to release its iPad tablet, which functioned as an e-reader. But Apple, like other retailers, was reluctant to enter the Amazon-dominated e-book market.²² Publishers recognized Apple's dilemma as an opportunity both to *increase* competition by helping Apple penetrate the market and to restore economic efficiency by ensuring that e-books were no longer sold below production cost. In order to effectuate this change, publishers and Apple "jointly agreed to alter the business model governing the relationship between publishers and retailers."²³

Until then, retailers had sold print and e-books according to the "wholesale" model. Under this model, publishers sold e-book titles to wholesale retailers at a fixed price,²⁴ and retailers resold the titles to consumers at whatever price they wished.²⁵ In place of the wholesale model, Apple and the publishers agreed to institute the "agency model."²⁶ Under the agency model, "publishers would take control of retail pricing by appointing retailers as 'agents.'"²⁷ Thus, instead of reselling e-books to consumers at any price they liked—as Amazon had been doing for years—agent retailers like Apple would sell e-book titles at publisher-determined prices. These retailers would receive a thirty-percent commission on each sale, guaranteeing them a profit²⁸ and precluding losses associated with below-cost e-book prices. With Apple entering the market and

²¹ Complaint, *supra* note 3, at 3.

²² *Id.*

²³ *Id.*

²⁴ Under the wholesale model, publishers usually sold books to retailers at fifty percent of the print book's "list price." See Competitive Impact Statement, *supra* note 10, at 3.

²⁵ *Id.* Under this system, an e-book with a list price of \$26.00 would be sold to Amazon for \$13.00. Amazon could in turn sell the title to consumers for \$9.99—a marginal loss of \$3.00. See Brief of Bob Kohn, *supra* note 11, at 20–21.

²⁶ Complaint, *supra* note 3, at 4.

²⁷ *Id.*

²⁸ *Id.*

publishers unanimously resolved to improve pricing, Amazon was forced to capitulate to the agency model.²⁹ This shift in model addressed the so-called “\$9.99 problem”³⁰ and permitted the reestablishment of tenable e-book prices—generally between \$12.99 and \$14.99.³¹

At last, on April 11, 2012, several years after the establishment of Amazon’s pernicious monopoly, the U.S. Department of Justice (“the DOJ” or “the government”) finally took action.³² Unfortunately, however, the government’s intervention defied both common logic and popular expectations.³³ In a shocking turn, the DOJ did not file an antitrust suit against Amazon, as many had expected it would.³⁴ Rather, to the utter dismay of the publishing industry,³⁵ the government brought charges against five of the Big Six book publishers.³⁶ In a complaint filed with the U.S. District

²⁹ *Id.* at 16, 25–28.

³⁰ *Id.* at 9–11.

³¹ *Id.* at 5.

³² See Complaint, *supra* note 3.

³³ See, e.g., Thomas Catan et al., *U.S. Alleges e-Book Scheme*, WALL ST. J. (Apr. 11, 2012), <http://online.wsj.com/article/SB10001424052702304444604577337573054615152.html>; Ylan Q. Mui & Hayley Tsukayama, *Justice Department Sues Apple, Publishers Over e-Book Prices*, WASH. POST (Apr. 11, 2012), http://www.washingtonpost.com/business/economy/justice-department-files-suit-against-apple-publishers-report-says/2012/04/11/gIQAzzyXSAT_story.html; Elizabeth Wasserman, *DOJ Sues Apple, Publishers On e-Book Prices*, POLITICO (Apr. 11, 2012), <http://www.politico.com/news/stories/0412/75028.html>.

³⁴ Many critics believe that the DOJ filed suit against the wrong party. For example, publishing industry analyst Mike Shatzkin noted, “It is an incredible irony that antitrust law is being used to protect the biggest monopolist.” John Gapper, *Don’t Make Amazon a Monopoly*, FIN. TIMES (Dec. 14, 2011), <http://www.ft.com/cms/s/0/ed2a1b20-2644-11e1-9ed3-00144feabdc0.html>. In an *amicus* brief to the district court, attorney Bob Kohn requested that the DOJ release its report on Amazon’s predatory pricing tactics. See Laura Hazard Owen, *Attorney Asks DOJ to Release Findings on Amazon’s “Predatory” Ebook Pricing*, PAIDCONTENT (Aug. 13, 2012, 1:06 PM), <http://paidcontent.org/2012/08/13/attorney-asks-doj-to-release-its-findings-on-amazons-predatory-pricing-of-ebooks/>.

³⁵ See Gapper, *supra* note 34; Owen, *supra* note 34.

³⁶ See Complaint, *supra* note 3. Of the “Big Six” publishers, only Random

Court for the Southern District of New York, the DOJ claimed that publishers illegally conspired with e-book retailer Apple to “limit competition in the sale of e-books.”³⁷ This, however, was a gross mischaracterization of both the motive and the effect of the publishers’ conduct. In its misapplication of antitrust law, the DOJ demonstrated not only a lack of understanding of the emerging e-book market, but also an appalling unfamiliarity with modern economic theory.

Still more shocking was the warm reception afforded by the United States District Court to the DOJ’s flawed antitrust argument. Even before *United States v. Apple, Inc.*³⁸ went to trial, Judge Denise Cote announced in a preliminary hearing that she believed the DOJ would prevail.³⁹ The court’s pointed prognostication augured poorly for the book publishers. Faced with the prospect of hopeless litigation and a predetermined outcome, each publisher eventually settled out of court—leaving only Apple to defend itself.⁴⁰ On July 10, 2013, following several weeks of a

House escaped suit. *See id.*

³⁷ *Id.* at 2.

³⁸ *United States v. Apple, Inc.*, 889 F. Supp. 2d 623, 626 (S.D.N.Y. 2012).

³⁹ *See* Phillip Elmer-DeWitt, *U.S. Judge in E-Book Antitrust Trial Says Apple is Likely to Lose*, CNN (May 24, 2013, 8:05 AM), <http://tech.fortune.cnn.com/2013/05/24/apple-ebooks-antitrust-judge/>. Judge Cote, hardly encouraging publishers to seek their day in court, stated: “I believe that the government will be able to show at trial direct evidence that Apple knowingly participated in and facilitated a conspiracy to raise prices of e-books, and that the circumstantial evidence in this case, including the terms of the agreements, will confirm that.” *Id.*

⁴⁰ Of the five publisher defendants charged in the DOJ complaint, Hachette, HarperCollins, and Simon & Schuster settled almost immediately. *See Apple, Inc.*, 889 F. Supp. 2d at 626. The remaining publishers—Penguin and Macmillan—eventually conceded to crushing settlement agreements. *See* Andrew Albanese, *Macmillan E-Book Settlement, Will Pay \$26 Million*, PUBLISHERS WEEKLY (Apr. 29, 2013), <http://www.publishersweekly.com/pw/by-topic/digital/content-and-e-books/article/57013-macmillan-finalizes-e-book-settlement-will-pay-26-million.html>; Julie Bosman, *Penguin to Pay \$75 Million in E-Book Settlement with States*, N.Y. TIMES (May 22, 2013), <http://www.nytimes.com/2013/05/23/business/media/penguin-to-pay-75-million-in-e-book-settlement-with-states.html> [hereinafter Bosman, *Penguin to Pay*].

contentious trial, Judge Cote issued her decision.⁴¹ The District Court held that “Apple had illegally conspired with five of the six biggest publishers to try to raise prices in the budding e-books market.”⁴² Before the case went to trial, such a notion—that publishers broke the law by correcting the artificial decline of e-book prices—might have been unthinkable. But what many commentators found a shocking judicial determination in light of Amazon’s e-book monopoly had, by the end of the *Apple* trial, come to be seen as a foregone conclusion.

The District Court’s conclusion in *United States v. Apple, Inc.* is misguided. When properly analyzed, nothing in the factual history of the case suggested that Apple or the book publishers acted improperly. Moreover, the DOJ’s suit against the defendants was based on faulty grounds. The DOJ argued that publishers harmed consumers by increasing the prices of e-books above the artificially low point created by Amazon.⁴³ In order to “effectuate their conspiracy,”⁴⁴ the DOJ contended, publishers entered into two types of business arrangements that are often the subject of antitrust law. First, in establishing the agency model, publishers effectuated a “vertical arrangement” with Apple.⁴⁵ An arrangement is *vertical* “when it links two markets in the same chain of manufacture and distribution, usually through the linkage of two firms that either do or could stand in the relationship of supplier and customer.”⁴⁶ In this case, the agency model created a vertical

⁴¹ *United States v. Apple, Inc.*, No. 12 Civ. 2826, 2013 WL 3454986 (S.D.N.Y. July 10, 2013).

⁴² David Streitfeld, *E-Book Ruling Gives Amazon an Advantage*, N.Y. TIMES (July 10, 2013), <http://www.nytimes.com/2013/07/11/business/e-book-ruling-gives-amazon-an-advantage.html> [hereinafter Streitfeld, *E-Book Ruling*].

⁴³ The government contends that “the goal of antitrust law . . . is to keep prices low for consumers’ benefit.” Response of Plaintiff United States to Public Comments on the Proposed Final Judgment at 21, *United States v. Apple, Inc.*, 889 F. Supp. 2d 623 (S.D.N.Y. 2012) (No. 12 Civ. 2826) (citation omitted). The “low price” principle, however, is completely unfounded in antitrust jurisprudence.

⁴⁴ Complaint, *supra* note 3 at 2.

⁴⁵ *See id.* at 2, 6–7, 16–30.

⁴⁶ ROBERT H. BORK, *THE ANTITRUST PARADOX* 18 (The Free Press 1993) (1978).

arrangement between the publishers (suppliers) and Apple (customer). The fact that book publishers and Apple agreed to sell e-books at certain predetermined prices constituted a “retail-price restraint,”⁴⁷ conduct that is widely presumed to be legal.⁴⁸ Such restraints are typically reviewed under “the rule of reason” standard, whereby courts consider not only the restraint itself, but its context, purpose and effect.⁴⁹

Second, according to the DOJ, publishers entered into a “horizontal arrangement” with one another when they communicated about setting new above-cost e-book prices.⁵⁰ A *horizontal* arrangement describes conduct by rivals in a single market—in this case, the five publishers in the e-book market—and often concerns price-setting.⁵¹ According to the DOJ, under current antitrust doctrine, horizontal price-setting of any kind is presumed to violate Section 1 of the Sherman Act,⁵² the quintessential antitrust statute. This means that, unlike the vertical retail-price restraint on e-books established between publishers and Apple, the horizontal price agreement among publishers would be evaluated under the *per se* illegal (the “*per se*”) standard.⁵³

The horizontal arrangement among publishers, therefore, was the central issue in *United States v. Apple, Inc.* Pursuant to the *per se* standard, defendants were not permitted to expound upon the nature of their industry or their reasons for entering a horizontal

⁴⁷ *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 551 U.S. 877, 878 (2007) (“The justifications for vertical price restraints are similar to those for other vertical restraints. Minimum resale price maintenance can stimulate interbrand competition among manufacturers selling different brands of the same type of product by reducing intrabrand competition among retailers selling the same brand.”).

⁴⁸ See JEFFREY L. KESSLER & SPENCER WEBER WALLER, *INTERNATIONAL TRADE AND U.S. ANTITRUST LAW* § 1:10 (2d ed.). See also *Leegin*, 551 U.S. at 877 (finding a vertical retail price restraint to be legal).

⁴⁹ Leslie, *supra* note 18, at 247.

⁵⁰ See Complaint, *supra* note 3, at 18–26. The DOJ alleged that publishing executives engaged in numerous phone conversations and meetings in order to establish the agency model and combat Amazon’s predatory pricing. *Id.* at 12.

⁵¹ BORK, *supra* note 46, at 17–18.

⁵² Complaint, *supra* note 3, at 32.

⁵³ *Id.*

arrangement.⁵⁴ Therefore, although the *Apple* case presented complicated facts concerning a unique and changing industry, not to mention the circumstances of Amazon's monopoly, the court gave publishers and Apple little opportunity to explain their conduct. Because the publishers, like Apple, would have been summarily found guilty of price fixing, it is no surprise that they resigned themselves to unfavorable settlement agreements. Not only have they agreed to abandon the robust agency model, but publishers must pay enormous fines. Penguin Group, for instance, resolved to pay \$75 million in "consumer damages" rather than go before a federal judge who had already determined its fate.⁵⁵

This Note contends that contemporary antitrust policy is built upon shaky doctrinal ground and must be reevaluated. The fact that it is per se illegal, under current law, for book publishers to attempt to stop Amazon's predatory tactics demonstrates that U.S. antitrust policy is in a sad state of disrepair.⁵⁶ Still more upsetting is the fact that, under the per se standard, publishers have been dissuaded from telling their story to the court. Accordingly, the *United States v. Apple, Inc.* decision presents a vital opportunity to reexamine our antitrust law. In short, the type of horizontal arrangements at the center of *United States v. Apple, Inc.* ought to be evaluated not only under the rule of reason, but under a *new, updated three-prong* rule of reason test that incorporates modern economic theory.⁵⁷

⁵⁴ *Id.*

⁵⁵ Bosman, *Penguin to Pay*, *supra* note 40.

⁵⁶ One need only read the 800 public comments written in opposition to this case to understand the outrage and confusion the DOJ's lawsuit has caused among authors, independent publishers, and booksellers. See *Antitrust Division: United States v. Apple, Inc.*, et al., U.S. DEP'T OF JUSTICE, <http://www.justice.gov/atr/cases/apple/index.html> (last visited Oct. 26, 2013).

⁵⁷ This theory will draw from two primary sources. First is the basic tenets of the Chicago School of Economics, as espoused by Bork in his seminal book on antitrust law, which value economic efficiency in a market above all else. See generally BORK, *supra* note 46. The second source is the so-called "theory of the second best," which suggests that one failure in a particular market may be corrected by a second failure. R.G. Lipsey & Kevin Lancaster, *The General Theory of Second Best*, in READINGS IN SOCIAL WELFARE: THEORY AND POLICY 47, 48 (Robert Kuenne ed., 2000).

As background, Part I provides a brief history of antitrust law. Part I.A recounts the emergence of the law's governing standards—the traditional *per se* and the rule-of-reason standards—while Part I.B identifies some of the fallacious ideas that continue to plague antitrust law. Part II describes two positive trends in antitrust law arising from modern economic theory that support the adoption of a new, updated three-prong rule of reason. The first is a move away from *per se* analysis; the second is a growing realization that economic efficiency is the best measure of antitrust policy and the most effective way to promote consumer welfare. Part III reviews Supreme Court precedent supporting the argument that, in *United States v. Apple, Inc.*, publishers' horizontal arrangement should have been analyzed under a general test pursuant to the rule of reason standard. Part IV sets forth a new specific three-part economic-effects test for horizontal arrangements, whereby an arrangement may be found legal when (1) the relevant economic market is unfamiliar or unique, (2) the horizontal arrangement is ancillary to a proper aim, and (3) the arrangement improves economic efficiency. The Note concludes that under this new standard the publishers' horizontal arrangement in *United States v. Apple, Inc.* should be found legal upon appeal.

In *United States v. Apple, Inc.*, the DOJ and the District Court harmed both the publishing industry and modern antitrust-law policy. "The Department of Justice has unwittingly caused further consolidation in the industry at a time when consolidation is not necessarily a good thing," said Mark Coker, the chief executive of an e-book distributor. "If you want a vibrant ecosystem of multiple publishers, multiple publishing methods and multiple successful retailers in 5, 20 or 50 years, we took a step backwards [with the District Court's decision]." ⁵⁸ While both Apple and the publishers were punished by the court, Amazon has been left to reestablish its monopoly over the e-book market through predatory pricing. ⁵⁹ But there is still hope. Recent reports suggest that Apple plans to appeal the District Court's decision. ⁶⁰ Thus, the U.S. Court of

⁵⁸ Streitfeld, *E-Book Ruling*, *supra* note 42.

⁵⁹ *Id.*

⁶⁰ Blair Hanley Frank, *Apple Loses E-books Antitrust Case, but Vows to Appeal*, GEEKWIRE (July 10, 2013, 8:52 AM), <http://www.geekwire.com/2013/>

Appeals for the Second Circuit—and perhaps even the U.S. Supreme Court—will be given an opportunity to address the dire state of contemporary antitrust law. Should the higher courts reconsider their policy in light of modern economic theory, it is possible that the next decision in *United States v. Apple, Inc.* will be the right one.

I. THE CHECKERED HISTORY OF ANTITRUST LAW

On July 2, 1890, President Benjamin Harrison signed into law Bill S. 1, later called the Sherman Act.⁶¹ The “oldest and most basic of the antitrust statutes,”⁶² the Act originally comprised only two terse sections. Its plain language, however, was expansive in scope:

Section 1: Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is hereby declared illegal.⁶³

Section 2: Every person who shall monopolize, or attempt to monopolize, or combine and conspire with any other person, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a misdemeanor. . . .⁶⁴

The breadth of the text gave earlier federal courts considerable discretion in determining subsidiary antitrust laws.⁶⁵ This could

[apple-loses-ebook-antitrust-case/](#)

⁶¹ BORK, *supra* note 46, at 19.

⁶² *Id.* at 61.

⁶³ *Id.* at 19 (alteration in original) (quoting 15 U.S.C.A. § 1 (1890)).

⁶⁴ *Id.* at 20 (quoting 15 U.S.C.A. § 2). In subsequent versions of Section 2, “misdemeanor” was replaced with “felony.” *See* 15 U.S.C. § 2 (2012).

⁶⁵ BORK, *supra* note 46, at 20. *See also* WILLIAM HOLMES & MELISSA MANGIARACINA, *ANTITRUST LAW HANDBOOK* § 2:9 (2012) (“Taken literally, [the] extremely broad language [of Section 1] would prohibit virtually any business combination or agreement, including competitively desirable as well as undesirable arrangements. Not surprisingly, the courts have interpreted the statute far more narrowly . . .”).

hardly have been considered problematic, as the goal of the Sherman Act might have appeared clear enough.⁶⁶ The statute would promote consumer welfare by preventing the formation of harmful business arrangements and ensuring healthy market competition.⁶⁷ Specifically, Section 1 precluded horizontal arrangements, like cartels and mergers,⁶⁸ while Section 2 prohibited the formation of monopolies through predatory tactics.⁶⁹ The Sherman Act thus had a simple purpose with a clear application.

One hundred and twenty-two years later, this has proven not to be the case. Today's antitrust policy is muddled at best. The purpose of the Sherman Act is frequently misplaced;⁷⁰ indeed, one need look no further than the DOJ's incorrect claim, in *United States v. Apple, Inc.*, that the goal of antitrust law is to ensure the lowest price of goods.⁷¹ Despite its terseness, the "singularly

⁶⁶ Even so, Judge Richard Posner suggests that the framers approached the law with contradictory aims. See RICHARD A. POSNER, ANTITRUST LAW 34 (2d ed. 2001). On the one hand, they were concerned with trusts and monopolies harming smaller businesses with predatory pricing; on the other hand, they wished to prevent powerful businesses from harming customers with high prices. *Id.* In the end, "[p]rotecting competitors from low prices and consumers from high prices are incompatible objectives . . ." *Id.*

⁶⁷ See BORK, *supra* note 46, at 17; see also *United States v. Addyston Pipe & Steel Co.*, 85 F. 271, 281 (6th Cir. 1898) (finding that contracts legal pursuant to the Sherman Act are upheld "because it is for the benefit of the public at large that they should be enforced"), *aff'd as modified*, 175 U.S. 211 (1899). The Supreme Court later determined "that that the Sherman Act only invalidated those agreements which 'unreasonably' restrain trade. The Court defined the term 'unreasonable' by equating it with 'anticompetitive.' Consequently, the effect on competition soon became the primary, if not sole, focus determining the reasonableness of a challenged trade restraint." Leslie, *supra* note 18, at 245 (citing *Standard Oil Co. v. United States*, 221 U.S. 1 (1911)).

⁶⁸ BORK, *supra* note 46, at 19–20.

⁶⁹ *Id.* at 20.

⁷⁰ See, e.g., *id.* at 16–49 (describing, *inter alia*, the missteps of Justice Hughes).

⁷¹ See Response of Plaintiff United States to Public Comments, *supra* note 43, at 21. As we will see, the true goal of antitrust policy is the promotion of consumer welfare through increased economic efficiency (and not, as the government claimed in the Apple case, the lowest price of goods).

opaque⁷² language of the Sherman Act has given rise to inconsistent precedent.⁷³ This is due, in large part, to the courts' failure to apply reliable and consistent doctrines to the statute's bare language. As Professor Andrew Gavill has quipped, "After one hundred years one might expect a rule of law to be settled."⁷⁴ But apparently this is expecting too much. The courts have muddied the waters of antitrust jurisprudence, and, before we attempt to clear things up, the turgidity is worth examining.

A. Early Antitrust Law: Per Se Illegality and the Rule of Reason

As Judge Posner laments, antitrust law has always suffered from a rather "confusing history."⁷⁵ Its progress, however, is marked by at least one persistent theme: the ongoing tension between the rule of per se illegality and the rule of reason.⁷⁶ Both are standards by which the courts evaluate alleged Sherman Act violations. The per se rule is a black-letter prohibition on specific types of business arrangements.⁷⁷ These business arrangements traditionally govern restraints that are purely anticompetitive; thus,

⁷² BORK, *supra* note 46, at 20.

⁷³ *Id.* at 17.

⁷⁴ Andrew I. Gavil, *Moving Beyond Caricature and Characterization: The Modern Rule of Reason in Practice*, 85 S. CAL. L. REV. 733, 733 (2012).

⁷⁵ POSNER, *supra* note 66, at 34 n.5.

⁷⁶ The Supreme Court has since noted that the per se rule and the rule of reason in fact occupy two ends of the same spectrum. *See Nat'l Collegiate Athletic Ass'n v. Bd. of Regents of Univ. of Okla.*, 468 U.S. 85, 104 n.26 (1984) ("[N]o bright line separat[es] per se from Rule of Reason analysis."); *see also* HOLMES & MANGIARACINA, *supra* note 65, § 2:9 ("The distinction between practices deemed per se illegal, and those that are instead to be judged by the rule of reason or by some intermediate standard, is anything but immutable. . . . [P]ractices that have at one time been analyzed under one test have later been brought under an altogether different standard."); Thomas A. Piraino, Jr., *Making Sense of the Rule of Reason: A New Standard for Section 1 of the Sherman Act*, 47 VAND. L. REV. 1753, 1769 (1994) [hereinafter Piraino, *Making Sense of the Rule of Reason*] ("The courts can clarify Section 1 analysis by recognizing that the rule of reason and per se rules are not opposite theoretical approaches but simply different evidentiary standards.").

⁷⁷ Leslie, *supra* note 18, at 245.

in order for the government to justify a per se prohibition, such a restraint must “lack any redeeming virtue.”⁷⁸ When a particular restraint falls within the per se category, it is deemed unreasonable as a matter of law;⁷⁹ thus, courts do not consider its context, purpose, or effect on the economic market. A number of restraints—including group boycotts, tying arrangements, and the division of markets—have been deemed per se illegal by the U.S. Supreme Court.⁸⁰ It is the type of horizontal price-fixing at the center of *United States v. Apple, Inc.*, however, that is considered the “epitome of a per se violation.”⁸¹

The traditional rule of reason, on the other hand, constitutes a more nuanced analysis of business conduct. It requires that courts consider not only the trade restraint itself, but its context, purpose, and effect.⁸² This means evaluating the nature of the industry, the reasons that the restraint was imposed, and whether or not it has had the desired consequence.⁸³ Through an economic effects test, a “court may determine that the procompetitive benefits of a specific restraint outweigh its anticompetitive effects and, accordingly, allow it to survive the rule of reason.”⁸⁴

Both standards first surfaced in *United States v. Trans-Missouri Freight Ass’n*,⁸⁵ an early antitrust case concerning a conspiracy among railroad operators to establish fixed rates.⁸⁶

⁷⁸ *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 551 U.S. 877, 886 (2007) (citation and internal quotation marks omitted).

⁷⁹ *See Leslie*, *supra* note 18, at 245.

⁸⁰ *Id.* at 246.

⁸¹ *Id.*; *see also United States v. Sacony-Vacuum Oil Co.*, 310 U.S. 150, 223 (1940) (finding per se illegal any “combination formed for the purpose and with the effect of raising, depressing, fixing, pegging, or stabilizing the price of a commodity in interstate or foreign commerce”).

⁸² *See Leslie*, *supra* note 18, at 247.

⁸³ *See Bd. of Trade of Chi. v. United States*, 246 U.S. 231, 238 (1918).

⁸⁴ *Leslie*, *supra* note 18, at 247.

⁸⁵ *United States v. Trans-Missouri Freight Ass’n*, 166 U.S. 290 (1897).

⁸⁶ *Id.* at 299. Led by Justice Peckham, the Supreme Court struck down the arrangement and “framed a rule of per se illegality for cartel price fixing.” BORK, *supra* note 46, at 23. One may argue that the per se rule arose from a broad reading of Section 1 of the Sherman Act: if an arrangement is overwhelmingly likely to restrict trade, then all similar arrangements are

Employing the per se rule, the majority proposed a predictable way to appraise horizontal arrangements that obviated the need for intricate economic analysis.⁸⁷ Thus, the majority in *Trans-Missouri* implicitly rejected a rule of reason standard,⁸⁸ though Justice White proposed precisely that standard in his dissent.⁸⁹ In a narrower reading of the Sherman Act, White argued that “only such contracts as unreasonably restrain trade are violative of the general law”⁹⁰ Thus, by butting heads with the majority, White set in motion the defining debate of antitrust law.

This debate amplified in 1898, when Judge Taft, in *United States v. Addyston Pipe & Steel, Co.*, dialed back the expansive per se rule. He did so with a seemingly counterintuitive proclamation: “[I]t is in the interest of trade that certain covenants in restraint of trade should be enforced.”⁹¹ The *Addyston* case, like *Trans-*

assumed to be illegal.

⁸⁷ In carving out a category of illegal conduct, the Court preferred a hatchet to a scalpel. See *N. Pac. Ry. Co. v. United States*, 356 U.S. 1, 5 (1958) (“[T]here are certain agreements or practices which because of their pernicious effect on competition and lack of any redeeming virtue are conclusively presumed to be unreasonable and therefore illegal without elaborate inquiry as to the precise harm they have caused or the business excuse for their use. This principle of per se unreasonableness . . . avoids the necessity for an incredibly complicated and prolonged economic investigation into the entire history of the industry involved”). See also BORK, *supra* note 46, at 26 (“[Peckham’s] rejection of a reasonable-price standard of legality may have saved the [Sherman Act] from becoming a judicially administered version of the National Recovery Administration, allowing cartels but policing their prices and behavior.”).

⁸⁸ Justice Peckham, like Chief Justice Taft after him, cautioned that “[i]f only that kind of contract which is in unreasonable restraint of trade be within the meaning of the statute, and declared therein to be illegal, it is at once apparent that the subject of what is a reasonable rate is attended with great uncertainty.” *Trans-Missouri*, 166 U.S. at 331. See also *Standard Oil Co. of N.J. v. United States*, 221 U.S. 1, 65 (1911) (As per se illegal arrangements “were clearly restraints of trade within the purview of the statute, they could not be taken out of that category by indulging in general reasoning as to the expediency or nonexpediency of having made the contracts, or the wisdom or want of wisdom of the statute which prohibited their being made.”).

⁸⁹ *Trans-Missouri*, 166 U.S. at 343–74 (White, J., dissenting).

⁹⁰ *Id.* at 344.

⁹¹ *United States v. Addyston Pipe & Steel Co.*, 85 F. 271, 280 (6th Cir. 1898).

Missouri Freight, concerned horizontal price restrictions—this time established by six manufacturers of cast iron pipe.⁹² Taft recognized that seemingly anticompetitive arrangements, which would typically fall into the per se illegal category, were sometimes beneficial. He reasoned, for instance, that a restraint is permissible if it is *ancillary* to a lawful contract.⁹³ To qualify as “ancillary,” a restraint “eliminating competition must be subordinate and collateral to a separate, legitimate transaction.”⁹⁴ For instance, Taft reasoned, a restraint is ancillary—and therefore lawful—when it acts only to protect one party from the unchecked competition of a competitor.⁹⁵ By introducing the doctrine of ancillary restraints, “Taft recognized that some restrictions upon rivalry are socially valuable”⁹⁶ and thus limited the number of business arrangements that fell under per se restrictions.⁹⁷ This loosening of the per se rule had the effect of encouraging beneficial agreements and promoting the original goal of antitrust policy: consumer welfare.⁹⁸

Justice White articulated a revised rule of reason in two companion opinions written in 1911—this time writing for the

⁹² *Id.* at 272–74.

⁹³ *Id.* at 282. Chief Justice Taft states that “no conventional restraint of trade can be enforced unless the covenant embodying it is merely ancillary to the main purpose of a lawful contract” *Id.* Taft thus demonstrated that the per se rule and the rule of reason might peaceably coexist, proposing “a rule of per se illegality for what have been called ‘naked restraints,’ agreements in which the parties engage in no significant dealings other than the elimination of competition,” and a rule of reason when ancillary restraints eliminate competition as a means of creating efficiency. BORK, *supra* note 46, at 27.

⁹⁴ BORK, *supra* note 46, at 27.

⁹⁵ *Addyston Pipe*, 85 F. at 282.

⁹⁶ BORK, *supra* note 46, at 27.

⁹⁷ Chief Justice Taft’s ancillary-restraints doctrine “would validate all vertical arrangements.” *Id.* at 29.

⁹⁸ *Addyston Pipe*, 85 F. at 281 (“Contracts for the partial restraint of trade are upheld, not because they are advantageous to the individual with whom the contract is made, and a sacrifice pro tanto of the rights of the community, but because it is for the benefit of the public at large that they should be enforced.”) (citation and internal quotation marks omitted).

Court's majority.⁹⁹ Both *Standard Oil Co. of New Jersey v. United States* and *United States v. American Tobacco Co.* reconfirmed that the Sherman Act's goal is the "maximization of consumer welfare."¹⁰⁰ Under White's revised rule of reason, the Court had to weigh certain factors before determining whether a restraint of trade was per se illegal or whether it merited closer analysis.¹⁰¹ Toward this end, White proposed what would become the standard three-prong economic-effects test.¹⁰² First, under the "inherent nature" prong, which incorporates the per se standard, the court determines whether an activity is presumed illegal.¹⁰³ Second, if the activity falls outside of the per se illegal category, the Court inquires as to its "inherent effect."¹⁰⁴ Finally, the court considers the "evident purpose" of the activity.¹⁰⁵ This three-prong economic-effects test would come to dominate Supreme Court

⁹⁹ See *Standard Oil Co. of N.J. v. United States*, 221 U.S. 1, 60–62 (1911); *United States v. Am. Tobacco Co.*, 221 U.S. 106, 179–80 (1911).

¹⁰⁰ BORK, *supra* note 46, at 34.

¹⁰¹ *Standard Oil*, 221 U.S. at 63. By emphasizing the importance of reason, Justice White found that "judgment must in every case be called into play in order to determine whether a particular act is embraced within the statutory classes, and whether, if the act is within such classes, its nature or effect causes it to be a restraint of trade within the intendment of the act." *Id.*

¹⁰² *American Tobacco*, 221 U.S. at 179 ("Applying the rule of reason to the construction of the statute, it was held in the *Standard Oil* Case that, as the words 'restraint of trade' at common law and in the law of this country at the time of the adoption of the anti-trust act only embraced acts or contracts or agreements or combinations which operated to the prejudice of the public interests by unduly restricting competition, or unduly obstructing the due course of trade, or which, either because of their inherent nature or effect, or because of the evident purpose of the acts, etc., injuriously restrained trade, that the words as used in the statute were designed to have and did have but a like significance."). See also BORK, *supra* note 46, at 34. Though not explicitly stated, the three-part test in *Standard Oil* comprises: the "[1] inherent nature or [2] effect of the restraint, as well as [3] the evident purpose of the acts . . ." *Id.* at 36.

¹⁰³ BORK, *supra* note 46, at 36.

¹⁰⁴ *Id.*

¹⁰⁵ *Id.* at 18–19, 36 ("Behavior not placed in the per se category is properly judged by the criteria of the intent which accompanies it and its probable effect upon competition.").

rule-of-reason jurisprudence over the next century.¹⁰⁶

This traditional three-part test also laid the foundation for Justice Brandeis' quintessential opinion in *Board of Trade of City of Chicago v. United States*.¹⁰⁷ The case concerned the Board of Trade's prohibition on grain sales between certain hours of the day.¹⁰⁸ Because the prices of grains temporarily remained constant, the effect of this conduct amounted to a limited type of price fixing.¹⁰⁹ The Court, nonetheless, sustained the restriction on the grain sales.¹¹⁰ Justice Brandeis, expanding upon the rule of reason proffered earlier by Justices White and Taft, found that price fixing could sometimes *improve* market conditions.¹¹¹ He then articulated what many have called the "classic formulation of the rule of reason."¹¹²

[T]he legality of an agreement or regulation cannot be determined by so simple a test, as whether it restrains competition. Every agreement concerning trade, every regulation of trade, restrains. To bind, to restrain, is of their very essence. The true test of legality is whether the restraint imposed is such as merely regulates and perhaps thereby promotes

¹⁰⁶ See, e.g., *Monsanto Co. v. Spray-Rite Serv. Corp.*, 465 U.S. 752, 762 (1984) (emphasizing "market impact" and "economic effect" of restraint); *Broad. Music, Inc. v. Columbia Broad. Sys., Inc.*, 441 U.S. 1, 19 (1979) (focusing "on whether the effect . . . threaten[s] the proper operation of our predominantly free-market economy"); *Cont'l T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 58–59 (1977) ("[D]eparture from the rule-of-reason standard must be based upon demonstrable economic effect . . ."); *Appalachian Coals, Inc. v. United States*, 288 U.S. 344, 368 (1933) ("The more serious question relates to the effect of the plan upon competition between defendants and other producers."), *overruled by Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752 (1984); *Bd. of Trade of Chi. v. United States*, 246 U.S. 231, 238 (1918) (under the rule of reason, courts must examine "the nature of the restraint and its effect, actual or probable").

¹⁰⁷ *Bd. of Trade of Chi.*, 246 U.S. at 231.

¹⁰⁸ *Id.* at 237, 239–40.

¹⁰⁹ Leslie, *supra* note 18, at 260–61.

¹¹⁰ *Bd. of Trade of Chi.*, 246 U.S. at 241.

¹¹¹ BORK, *supra* note 46, at 43.

¹¹² Piraino, *Making Sense of the Rule of Reason*, *supra* note 76, at 1761.

competition or whether it is such as may suppress or even destroy competition. To determine that question the court must ordinarily consider the facts peculiar to the business to which the restraint is applied; its condition before and after the restraint was imposed; the nature of the restraint and its effect, actual or probable. The history of the restraint, the evil believed to exist, the reason for adopting the particular remedy, the purpose or end sought to be attained, are all relevant facts. This is not because a good intention will save an otherwise objectionable regulation or the reverse; but because knowledge of intent may help the court to interpret facts and to predict consequences.¹¹³

This passage is important for several reasons. First, it promotes the ancillary restraint doctrine articulated by Taft and described above. Like Taft and White, Brandeis knew “that restraints on competition may often be a valuable and integral part of business arrangements, and that not all restraints should be condemned.”¹¹⁴ Second, by allowing courts to sustain arrangements that benefit the market, Brandeis also helped flesh out the standard three-prong economic-effects test introduced by White.¹¹⁵ Compared to previous versions of the rule of reason, Brandeis’ analysis was especially fact-intensive. His analysis permitted courts to look beyond competition and to consider circumstances peculiar to the industry in question. While the opinion did not explicitly reject a per se illegal category of conduct, at least one commentator has noted its absence from the text.¹¹⁶ Taken as a whole, the *Board of Trade* decision suggests that Brandeis favored a presumption of

¹¹³ *Bd. of Trade of Chi.*, 246 U.S. at 238.

¹¹⁴ Gavil, *supra* note 74, at 742.

¹¹⁵ *See id.* at 742–43 (“[The *Chicago Board* opinion] intuitively focused on the issues that lie at the core of the rule of reason inquiry and always have: the nature of the conduct, its purpose, and, perhaps most importantly, ‘its effect[s], actual or probable.’”) (citation omitted).

¹¹⁶ BORK, *supra* note 46, at 44 (“Most significant, perhaps, is his entire omission of any suggestion that there exists any category of restraints illegal per se.”).

reasonableness.¹¹⁷

B. The Pitfalls of Early Antitrust Law and Their Effect Today

Justice Hughes' 1911 opinion in *Dr. Miles Medical Co. v. John D. Park & Sons Co.*¹¹⁸ exemplifies the Court's frustrating tendency to undermine whatever progress it has made toward promoting a consistent rule of reason. Wishing to prevent price-cutting, Dr. Miles, a manufacturer of patent medicines, entered into an agency pricing agreement with its distributors.¹¹⁹ Through this arrangement, Dr. Miles was able to maintain uniform retail prices for its products.¹²⁰ Thus, this vertical retail-price restraint's only real economic effect was to prevent predatory pricing by distributors. The Supreme Court, however, viewed the vertical arrangement as a *per se* violation of the Sherman Act.¹²¹ Justice Hughes stated that Dr. Miles "can fare no better with its plan of identical contracts than could the dealers themselves if they formed a combination and endeavored to establish the same restrictions, and thus to achieve the same result, by agreement with each other."¹²² The Court thus effectively conflated horizontal price arrangements with vertical retail-price arrangements,¹²³ punishing

¹¹⁷ Under a presumption of reasonableness, the government must demonstrate a restraint's negative effect on the market before it could be deemed illegal. *See id.* at 46.

¹¹⁸ *Dr. Miles Med. Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911), *overruled by* *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 551 U.S. 877 (2007).

¹¹⁹ *Id.* at 374–93.

¹²⁰ *Id.* at 374–75.

¹²¹ *Id.* at 400–09.

¹²² *Id.* at 408.

¹²³ Judge Posner points out, with some dismay, that the Court justifies its odd theory with the bald assertion: "[t]hat these agreements restrain trade is obvious." Richard A. Posner, *Antitrust Policy and the Supreme Court: An Analysis of the Restricted Distribution, Horizontal Merger and Potential Competition Decisions*, 75 *COL. L. REV.* 282, 286 (1975) [hereinafter Posner, *Antitrust Policy*] (internal quotation marks omitted). The injury done by *Dr. Miles* is, of course, not "obvious." Like too much antitrust law, the Court's disapproval of vertical arrangements—along with price-fixing and horizontal

the manufacturer *Dr. Miles* for precluding retailers from selling its products at below-cost prices. The law of vertical retail-price maintenance was thereby “rendered mischievous and arbitrary”¹²⁴ and would not be remedied until *Leegin Creative Leather Products, Inc. v. PSKS, Inc.* finally overruled *Dr. Miles* in 2007.¹²⁵

Even so, antitrust policy today sometimes seems just as muddled as it did in 1911. In *United States v. Apple, Inc.*, for example, the DOJ charged publishers with entering an “illegal agreement” precluding predatory pricing.¹²⁶ This appears to be just another way of railing against vertical retail-price maintenance—in this case, the agency model—conduct that, since *Leegin*, should be considered legal.¹²⁷ Moreover, as a punitive measure, the District Court prohibited publishers from setting the retail prices of their e-books for a period of two years.¹²⁸ Again, the target of the court’s judgment is a vertical arrangement that is presumed legal. Thus, like *Dr. Miles*, the *Apple* decision undermines manufacturers’ ability to protect their products from predatory pricing by retailers. Held side by side, *Dr. Miles* and *Apple, Inc.* appear eerily similar to one another; both cases reveal the courts’ conflation of horizontal and vertical restraints, as well as their continuing—but unfounded—contempt for effective vertical retail-price restraints.

arrangements—rests on various misperceptions. See also BORK, *supra* note 46, at 16 (“Never has ‘experience’ demonstrated the anticompetitive nature of any of these practices.”).

¹²⁴ BORK, *supra* note 46, at 32.

¹²⁵ *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 551 U.S. 877, 882 (2007). Much like *Dr. Miles*, the *Leegin* case concerned a manufacturer that restricted the prices at which retailers could sell its goods by refusing to sell its products to those retailers that did not abide by the vertical retail-price restraint. *Id.* at 883. Instead of finding this type of vertical price restraint illegal, however, the Court declared “[w]e now hold that *Dr. Miles* should be overruled and that vertical price restraints are to be judged by the rule of reason.” *Id.* at 882.

¹²⁶ Competitive Impact Statement, *supra* note 10, at 8.

¹²⁷ That vertical and horizontal restraints lead to the same outcome, yet one is still considered legal while the other is not, should tell us something about the uncertainty inherent in antitrust policy.

¹²⁸ See Final Judgment as to Defendants Hachette, Harper Collins, and Simon & Schuster at 10, *United States v. Apple, Inc.*, 889 F. Supp. 2d 623 (S.D.N.Y. 2012) (No. 12 Civ. 2826).

By ruling against the book publishers simply because their agency model “achieve[d] the same result”¹²⁹ as retailer collusion, the District Court made the same mistake committed by the Supreme Court in *Dr. Miles* a hundred years ago.

Cases like *Dr. Miles* are instructive. They reveal that the Supreme Court has made some poor decisions resulting in shaky distinctions between cause and effect, evincing an infirm understanding of modern economic theory. These decisions have hobbled other courts as they handle cases like *Apple, Inc.* Yet, strangely, the problematic history of antitrust law is a cause for optimism. Cases like *Leegin* show that old errors can be resolved, and, moreover, that the Sherman Act “has a generality and adaptability comparable to that found to be desirable in constitutional provisions.”¹³⁰ This means that the law is apt to improve; courts can rid themselves of some old bugaboos (like discomfort with retail-price restraints) and, as a result, *United States v. Apple, Inc.* can be properly resolved.

II. TWO POSITIVE TRENDS IN MODERN ANTITRUST LAW

The Court has increasingly begun to recognize economic efficiency as the true measure of antitrust policy.¹³¹ This is

¹²⁹ *Dr. Miles Med. Co. v. John D. Park & Sons Co.*, 220 U.S. 373, 408 (1911), *overruled by* *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 551 U.S. 877 (2007).

¹³⁰ *Appalachian Coals, Inc. v. United States*, 288 U.S. 344, 360 (1933). *See also* *Standard Oil Co. of N.J. v. United States*, 221 U.S. 1, 64 (1911) (noting that the Sherman Act was “expressly designed not to unduly limit the application of the act by precise definition, but, while clearly fixing a standard, that is, by defining the ulterior boundaries which could not be transgressed with impunity, to leave it to be determined by the light of reason, guided by the principles of law and the duty to apply and enforce the public policy embodied in the statute, in every given case whether any particular act or contract was within the contemplation of the statute.”); Thomas A. Piraino, Jr., *Reconciling the Harvard and Chicago Schools: A New Antitrust Approach for the 21st Century*, 82 *IND. L.J.* 345, 346 (2007) [hereinafter Piraino, *Reconciling Harvard and Chicago Schools*] (“Over the 115 years since the adoption of the Sherman Act, the courts and enforcement agencies have altered their interpretation of the antitrust laws to match prevailing economic assumptions.”).

¹³¹ Leslie, *supra* note 18, at 244.

underscored by two important trends that have emerged in modern antitrust law. The first constitutes a steady move away from per se illegality and toward the traditional economic-effects test under the rule of reason.¹³² The second trend is a growing realization that market competition is not the only indicator of the successful application of antitrust law. When viewed together, both trends undermine the District Court's decision in *United States v. Apple, Inc.* Instead they indicate that the horizontal price-fixing arrangement between publishers is indeed permissible under the rule of reason because it increases efficiency in the e-book market.

A. The Shift from Per Se Illegality to Rule of Reason Analysis

Over time “there has been a general trend away from per se rules toward greater application of the standard rule of reason.”¹³³ Thus, some commentators recognize that “the rule of reason now has become the dominant form of analysis in Section 1 cases.”¹³⁴ The best explanation for this trend is the promulgation of modern economic theory.¹³⁵ Until the late 1960s, before the emergence of the so-called Chicago School of economics, “courts were enamored of the clarity, simplicity, and deterrent effects of per se rules.”¹³⁶ The application of the per se rule “reached its peak in 1967 when, in *United States v. Arnold, Schwinn & Co.*, the [Supreme] Court extended [it] to nonprice vertical restrictions imposed by a supplier on its distributors.”¹³⁷ This decision marked the height of the mistaken belief, rooted in *Dr. Miles* and persistent today, that all vertical restraints are per se illegal.

As economic theory has advanced, however, “the courts have grown disillusioned with the absolutism of the per se rule and have been more inclined to consider efficiency justifications for

¹³² See *id.* at 247–48.

¹³³ *Id.*

¹³⁴ Piraino, *Making Sense of the Rule of Reason*, *supra* note 76, at 1760.

¹³⁵ See Leslie, *supra* note 18, at 289–90 (explaining that application of per se rules became insufficient in price-fixing cases of the 1980s, leading the Supreme Court to adopt in-depth analysis closer to rule-of-reason analysis).

¹³⁶ Piraino, *Making Sense of the Rule of Reason*, *supra* note 76, at 1753–54.

¹³⁷ *Id.* at 1756.

competitive restraints.”¹³⁸ For example, the modern Supreme Court has noted that per se analysis “may sometimes prohibit restraints of trade that are harmless, efficient, competitive, or otherwise beneficial.”¹³⁹ Even outspoken proponents of the per se rule have conceded that it may have outlived its usefulness,¹⁴⁰ as a rule that is meant to be applied indiscriminately loses its value whenever it does not produce the correct result. Consequently, “the courts have narrowed the scope of the per se rule and expanded applications of the rule of reason.”¹⁴¹ Rather than using a hatchet to carve out antitrust policy, courts now prefer a scalpel: an economic-effects test based on the tests articulated by Justices White and Brandeis.¹⁴² To put it another way, “if the goal of the per se rule [was] to avoid discussion of economic efficiencies, it has failed.”¹⁴³ The retreat away from per se analysis is nicely demonstrated by the Supreme Court’s gradual disavowal of the reasoning in *Dr. Miles*.¹⁴⁴ Not only does this suggest that the Court

¹³⁸ *Id.* at 1754.

¹³⁹ Leslie, *supra* note 18, at 246 & n.13 (“The administrative efficiency interests in antitrust regulation are unusually compelling.” (quoting *F.T.C. v. Superior Court Trial Lawyers Ass’n*, 493 U.S. 411, 430 (1990))).

¹⁴⁰ Professor Bork, for instance, concedes that while it has done some good, “it is also true that the [per se] rule has become somewhat skewed over time, and on occasion produces undesirable results.” BORK, *supra* note 46, at 263.

¹⁴¹ Piraino, *Making Sense of the Rule of Reason*, *supra* note 76, at 1754.

¹⁴² See Gavil, *supra* note 74, at 734 (“The rule of reason has evolved considerably since *Standard Oil* and *Chicago Board of Trade*, largely due to the Court’s own march away from per se rules and undemanding burdens of proof. As that march began in the late 1970s, the Court moved to add contemporary economic content to the broad principles articulated in *Chicago Board of Trade*. In formative cases like *Continental T.V., Inc. v. GTE Sylvania Inc.*; *National Society of Professional Engineers v. United States*; *Broadcast Music, Inc. v. CBS*; and *NCAA v. Board of Regents of the University of Oklahoma*, the modern era’s rule of reason was honed to focus on specific, core economic concepts, especially anticompetitive effect and efficiency.”).

¹⁴³ Leslie, *supra* note 18, at 290.

¹⁴⁴ See *United States v. Gen. Elec. Co.*, 272 U.S. 476, 488 (1926) (circumventing *Dr. Miles* to approve a genuine agency model); *White Motor Co. v. United States*, 372 U.S. 253, 265–66 (1963) (finding that per se analysis of vertical restraints is justified only when the Court possesses a long-held understanding of the market); *Cont’l T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S.

has begun to favor the rule of reason, but also that it recognizes horizontal and vertical arrangements may have very different causes and effects. Even though antitrust law has seen an ongoing “erosion of the per se rule,”¹⁴⁵ a further extension of the rule of reason is required to account for instances of beneficial horizontal price arrangements such as the one in *United States v. Apple, Inc.* This rule-of-reason analysis must depart from earlier models by taking into account, among other factors, the benefits of economic efficiency.

B. Market Efficiency as the Best Indicator of Consumer Welfare

The incorrect notion that competition alone should guide antitrust law is deeply ingrained in the earliest antitrust cases.¹⁴⁶ In *Standard Oil*, for instance, the Supreme Court held that only “anticompetitive” arrangements are invalid under the Sherman Act.¹⁴⁷ “Consequently, the effect on competition soon became the primary, if not sole, focus determining the reasonableness of a

36, 57 (1977) (reversing *Schwinn* and finding that non-price vertical arrangements are better judged by the rule of reason); *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 551 U.S. 877, 889 (2007) (finding that “it is necessary to examine, in the first instance, the economic effects of vertical agreements to fix minimum resale prices[,] and to determine whether the *per se* rule is nonetheless appropriate.”).

¹⁴⁵ Piraino, *Making Sense of the Rule of Reason*, *supra* note 76, at 1757–58.

¹⁴⁶ See *Standard Oil Co. of N.J. v. United States*, 221 U.S. 1, 97 (1911); *Olympia Equip. Leasing Co. v. W. Union Tel. Co.*, 797 F.2d 370, 375 (7th Cir. 1986); see also BORK, *supra* note 46, at 7 (“There are many problems here, but perhaps the core of the difficulty is that the courts, and particularly the Supreme Court, have failed to understand and give proper weight to the crucial concept of business efficiency.”).

¹⁴⁷ *Standard Oil*, 221 U.S. at 58 (“Without going into detail, and but very briefly surveying the whole field, it may be with accuracy said that the dread of enhancement of prices and of other wrongs which it was thought would flow from the undue limitation on competitive conditions caused by contracts or other acts of individuals or corporations led, as a matter of public policy, to the prohibition or treating as illegal all contracts or acts which were unreasonably restrictive of competitive conditions . . .”).

challenged trade restraint.”¹⁴⁸ This misperception has guided antitrust policy for the last hundred years, but no longer is it blindly accepted.¹⁴⁹ Courts now realize that market efficiency is a relevant measure of antitrust policy and the best way to promote consumer welfare.¹⁵⁰

Only recently has economic theory considered the idea that efficiency is the goal of antitrust law.¹⁵¹ This theory arises from the Chicago School, which Judges Bork and Posner first applied to antitrust law in the 1970s.¹⁵² According to the Chicago School, efficiency is the chief object of the Sherman Act.¹⁵³ “Because efficiency is the maximization of social utility, the Chicago School’s standard is often called the ‘consumer welfare’ standard.”¹⁵⁴ Thus, the efficiency standard, by maximizing consumer welfare, is aligned with the true goal of the Sherman Act.¹⁵⁵

According to the Chicago School, competition and efficiency are not synonymous: in fact, competition can sometimes be

¹⁴⁸ Leslie, *supra* note 18, at 245.

¹⁴⁹ *Id.* at 244.

¹⁵⁰ *Id.*

¹⁵¹ See Gavil, *supra* note 74, at 735 (“The various frameworks of the new rules of reason are all animated by a common purpose: to differentiate anticompetitive from efficient conduct In application, these ‘new rules of reason’ have more economic content and more of a defined legal framework than did the seemingly more abstract *Standard Oil* and *Chicago Board of Trade* approach.”).

¹⁵² See generally BORK, *supra* note 46; POSNER, *supra* note 66; Robert H. Bork, *The Rule of Reason and the Per Se Concept: Price Fixing and Market Division II*, 75 YALE L. REV. 373 (1965); Posner, *Antitrust Policy*, *supra* note 123.

¹⁵³ Leslie, *supra* note 18, at 250. See also BORK, *supra* note 46, at xi.

¹⁵⁴ Leslie, *supra* note 18, at 251.

¹⁵⁵ See BORK, *supra* note 46, at 78, 262. Bork contends that “the only legitimate goal of antitrust is the maximization of consumer welfare,” so that “[t]he responsibility of the federal courts for the integrity and virtue of law requires that they take consumer welfare as the sole value that guides decisions.” *Id.* at 51. Moreover, Bork warns that “[w]hen efficiency is not counted, or when it is seen as a positive evil, it appears that no business structure of behavior has any potential for social good, and there is consequently no reason to uphold its legality if any remote danger can be imagined.” *Id.* at 8.

inefficient.¹⁵⁶ This is because while efficiency is an end in itself, competition is just one possible means of achieving it.¹⁵⁷ Businesses often enhance their efficiency more effectively by collaborating with—and thus by limiting their competition with—other businesses.¹⁵⁸ Courts that persist in elevating competition over efficiency are therefore guilty of overemphasizing the means and shortchanging the real end of antitrust law: consumer welfare.¹⁵⁹ If the purpose of antitrust laws is to preserve market efficiency, sometimes competition must be set aside. Otherwise, a “blind obedience to competition is simply bad economics.”¹⁶⁰

The Supreme Court has previously questioned the sanctity of relying only on the competition standard. In *Northern Securities Co. v. United States*,¹⁶¹ Justice Holmes dissented: “The court below argued as if maintaining competition were the expressed object of the act. The act says nothing about competition.”¹⁶² Like Taft in *Addyston Pipe*, Holmes argued that it is lawful to abolish competition in the service of efficiency.¹⁶³ Justice Brandeis, in

¹⁵⁶ Leslie, *supra* note 18, at 271.

¹⁵⁷ Professor Bork distinguishes competition from efficiency by stating that the former “is inherently a process in which rivals seek to exclude one another,” while efficiency “tends to exclude firms that are less efficient.” BORK, *supra* note 46, at 49. Moreover, Judge Posner has held that the emphasis of antitrust has shifted from “the protection of competition as a *process* of rivalry to the protection of competition as a *means* of promoting economic efficiency.” *Olympia Equip. Leasing Co. v. W. Union Tel. Co.*, 797 F.2d 370, 375 (7th Cir. 1986). See also Leslie, *supra* note 18, at 255 (“Competition and allocative efficiency . . . maintain a strict means-end relationship. Competition is a means to achieve allocative efficiency.”).

¹⁵⁸ Piraino, *Making Sense of the Rule of Reason*, *supra* note 76, at 1768.

¹⁵⁹ Leslie, *supra* note 18, at 271.

¹⁶⁰ *Id.*

¹⁶¹ *N. Sec. Co. v. United States*, 193 U.S. 197 (1904).

¹⁶² *Id.* at 403.

¹⁶³ *Id.* at 406. (“[Section 1], taken alone, does not require that all existing competitions shall be maintained. It does not look primarily, if at all, to competition. It simply requires that a party’s freedom in trade between the states shall not be cut down by contract with a stranger. So far as that phrase goes, it is lawful to abolish competition by any form of union.”). Similarly, Judge Taft held that “to be ancillary, and hence lawful, an agreement eliminating competition must be subordinate and collateral to a separate, legitimate

Chicago Board, offered the pithiest refutation of competition, stating simply, “the legality of an agreement or regulation cannot be determined by so simple a test, as whether it restrains competition.”¹⁶⁴

Today, some lower courts and commentators recognize that efficiency is the “appropriate objective when analyzing antitrust issues.”¹⁶⁵ Although the Supreme Court has been slow in coming around, key cases demonstrate its willingness to consider efficiency.¹⁶⁶ For instance, in *Appalachian Coals, Inc. v. United States*, a case concerning the struggling coal industry, the Court upheld the manufacturers’ restraint on prices on efficiency grounds.¹⁶⁷ Similarly, in *Continental T.V., Inc. v. GTE Sylvania*, the Court found that non-price vertical restrictions¹⁶⁸ limiting the number of franchise retailers that sold Sylvania’s electronic products were legal when they allowed “the manufacturer to

transaction.” BORK, *supra* note 46, at 27. This occurred when “the elimination of competition was a means of creating efficiency.” *Id.* at 264.

¹⁶⁴ *Bd. of Trade of Chi. v. United States*, 246 U.S. 231, 244 (1918).

¹⁶⁵ Leslie, *supra* note 18, at 252 (“[C]ourts, commentators, and even critics have more or less reached a consensus that efficiency is the appropriate objective when analyzing anti-trust issues.”).

¹⁶⁶ For examples of cases in which the Supreme Court has deemed considerations of efficiency irrelevant to antitrust law, see *Socony-Vacuum Oil Co. v. United States*, 310 U.S. 150, 224 n.59 (1940) (“Whatever economic justification particular to price-fixing agreements may be thought to have, the law does not permit an inquiry into their reasonableness.”); *Nat’l Soc’y of Prof’l Eng’rs v. United States*, 435 U.S. 679, 692 (1978) (finding that the rule of reason “is not to decide whether a policy of favoring competition is in the public interest”).

¹⁶⁷ *Appalachian Coals, Inc. v. United States*, 288 U.S. 344 (1933), *overruled by* *Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752 (1984). Much like the *Apple* case, *Appalachian Coals* concerned a group of struggling producers (in this case, coal producers rather than book publishers) who instituted price restraints on their products in order to improve the efficiency of the market.

¹⁶⁸ *Cont’l T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 37 (1977) (describing the central vertical non-price restraint as follows: “Franchise agreements between manufacturers and retailers . . . includ[ed] provisions barring the retailers from selling franchised products from certain locations other than those specified in the agreements.”).

achieve certain efficiencies in the distribution of his products.”¹⁶⁹ Additionally, in *Broadcast Music, Inc. v. Columbia Broadcast Systems*, a television network brought an antitrust action against music licensors, claiming that the model under which the licensors set fees for blanket licenses to perform musical compositions constituted illegal price fixing.¹⁷⁰ Nonetheless, the Court sustained the horizontal restraint because it would “increase economic efficiency.”¹⁷¹ Indeed, many federal appellate courts have already recognized that efficiency is the goal of antitrust law, and competition simply a means to that end.¹⁷² However, the Supreme Court has not yet followed suit. “[T]he Court must do more than merely acknowledge the means-end relationship between competition and . . . efficiency.”¹⁷³ In order to ensure maximization of consumer welfare, courts must adopt efficiency as the *primary* goal of antitrust policy.

¹⁶⁹ *Id.* at 57. Much like the book publishers in the *Apple* case, Sylvania abandoned the wholesale model for a franchise sales model permitting it to pick which retailers sold its products and under what terms sales were to be conducted. *See id.* at 38–39.

¹⁷⁰ *Broad. Music, Inc. v. Columbia Broad. Sys., Inc.*, 441 U.S. 1 (1979).

¹⁷¹ *Id.* at 20. The Court noted the importance of considering whether a price restraint tends to “threaten the proper operation of our predominantly free-market economy” or whether it is “one designed to ‘increase economic efficiency and render markets more, rather than less, competitive.’” *Id.* As we will see, the publishers’ price restraints in the *Apple* case both promoted the proper operation of the market and made it more competitive, namely by ending Amazon’s monopoly and allowing Apple to enter the e-book market.

¹⁷² Leslie, *supra* note 18, at 255. *See also* *Olympia Equip. Leasing Co. v. W. Union Tel. Co.*, 797 F.2d 370, 375 (7th Cir. 1986); *Rothery Storage & Van Co. v. Atlas Van Lines, Inc.*, 792 F.2d 210 (D.C. Cir. 1986).

¹⁷³ Leslie, *supra* note 18, at 274.

III. HORIZONTAL ARRANGEMENTS PROMOTING EFFICIENCY ARE SUBJECT TO THE RULE OF REASON

It is no longer a viable policy for courts and regulators to consider horizontal price-fixing the “epitome of a per se violation.”¹⁷⁴ As we have seen, the Sherman Act “has great generality and adaptability.”¹⁷⁵ Antitrust law is apt to change as the courts extend the rule of reason to conduct once presumed illegal.¹⁷⁶ The Supreme Court has already adjusted its policy regarding vertical restraints; it overruled *Dr. Miles* and recognized that retail-price maintenance is subject to evaluation under the rule of reason.¹⁷⁷ The same adjustment must be made for horizontal price fixing.

Supreme Court precedent supports such an argument. In *Chicago Board of Trade*, the Court, for the first time, upheld an apparent horizontal price-fixing arrangement under the rule of reason.¹⁷⁸ Justice Brandeis found that the result of the Board’s price fixing “had actually been to improve market conditions.”¹⁷⁹ Fifteen years later, in *Appalachian Coals*, the Court again upheld a horizontal price-fixing arrangement.¹⁸⁰ In that case, coal producers

¹⁷⁴ *Id.* at 246. See also *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150, 223 (1940) (finding per se illegal any “combination formed for the purpose and with the effect of raising, depressing, fixing, pegging, or stabilizing the price of a commodity in interstate or foreign commerce.”).

¹⁷⁵ *Appalachian Coals, Inc. v. United States*, 288 U.S. 344, 359–60 (1933), overruled by *Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752 (1984).

¹⁷⁶ See HOLMES & MANGIARACINA, *supra* note 65, § 2:9 (“The distinction between practices deemed per se illegal, and those that are instead to be judged by the rule of reason or by some intermediate standard, is anything but immutable . . . practices that have at one time been analyzed under one test have later been brought under an altogether different standard.”).

¹⁷⁷ *Creative Leather Prods. Inc. v. PSKS Inc.*, 551 U.S. 877, 908 (2007).

¹⁷⁸ *Leslie*, *supra* note 18, at 260 (arguing that the Court sustained a restriction that “amounted to, at the least, a variation of price-fixing”).

¹⁷⁹ BORK, *supra* note 46, at 44.

¹⁸⁰ *Appalachian Coals*, 288 U.S. at 378; see also *Leslie*, *supra* note 18, at 261 (“[T]he Court sustained an agreement which was, for all intents and purposes, a horizontal price-fixing agreement.”).

created an “exclusive selling agency” to increase coal production, “achieve economies in marketing,” and eliminate “destructive trade practices.”¹⁸¹ The Court declined to apply the per se rule,¹⁸² effectively sustaining the arrangement because it purportedly corrected market failures in the coal industry and led to the “more economic sale of coal.”¹⁸³ Echoing Brandeis in *Chicago Board of Trade*, the Court examined the “conditions peculiar to the coal industry” when it determined the ultimate purpose and effect of the horizontal restraint.¹⁸⁴ The Court thereby found that the restraint “mitigated recognized evils” unique to the industry.¹⁸⁵ The Court did not explicitly say as much, but an “efficiency exception to the per se rule doctrine was being carved out.”¹⁸⁶

Recent cases have begun to embrace the notion that economic efficiency justifies price-setting.¹⁸⁷ The 1970s saw the Court begin to adjust its traditional per se approach in order to provide defendants an occasion to explain their economic rationale for horizontal restrictions on price.¹⁸⁸ In the most important of these cases, *Broadcast Music, Inc. v. Columbia Broadcasting System, Inc.*, the Court held that defendants’ price restriction on blanket music licenses ought to be examined under a rule-of-reason analysis.¹⁸⁹ Tellingly, the Court noted that “easy labels do not always supply ready answers,”¹⁹⁰ and found that not all price restrictions among competitors are “per se violations of the Sherman Act or even unreasonable restraints.”¹⁹¹

In applying the rule of reason to the defendants’ price-fixing scheme, the Court made two essential points. First, it held that

¹⁸¹ *Appalachian Coals*, 288 U.S. at 358.

¹⁸² *Id.* at 360–61; *see also* Leslie, *supra* note 18, at 262.

¹⁸³ *Appalachian Coals*, 288 U.S. at 367.

¹⁸⁴ *Id.* at 368.

¹⁸⁵ *Id.* at 367.

¹⁸⁶ Leslie, *supra* note 18, at 262.

¹⁸⁷ *Id.* at 260.

¹⁸⁸ Piraino, *Making Sense of the Rule of Reason*, *supra* note 76, at 1781.

¹⁸⁹ *Broad. Music, Inc. v. Columbia Broad. Sys., Inc.*, 441 U.S. 1, 7 (1979).

¹⁹⁰ *Id.* at 8.

¹⁹¹ *Id.* at 23.

special attention must be paid when conditions are “*sui generis*”¹⁹² and therefore, that the Sherman Act should be “discriminatingly applied in light of economic realities.”¹⁹³ In this respect, *Broadcast Music, Inc.* echoes early decisions¹⁹⁴ and presages later ones¹⁹⁵ in requiring that the Court tailor its analysis to the relevant market.¹⁹⁶ When the market is unique, the rule of reason is appropriate.¹⁹⁷ Second, the Court applied the nuanced economic-effects test¹⁹⁸ in

¹⁹² *Id.* at 10 (quoting *Columbia Broad. Sys., Inc.*, 562 F.2d at 132).

¹⁹³ *Id.* at 14 (quoting Brief for United States as Amicus Curiae on Petition for Certiorari at 10–11, *K-91, Inc. v. Gershwin Publ’g Corp.*, 88 S.Ct. 761 (1968) (No. 147)).

¹⁹⁴ See *Appalachian Coals, Inc. v. United States*, 288 U.S. 344, 360 (1933) (“[A] close and objective scrutiny of particular conditions and purposes is necessary in each case. Realities must dominate the judgment.”); *Bd. of Trade of Chi. v. United States*, 246 U.S. 231, 238 (1918) (“[T]he court must ordinarily consider the facts peculiar to the business to which the restraint is applied . . .”).

¹⁹⁵ See *Cont’l T. V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 49 (1977) (“[T]he factfinder weighs all of the circumstances of a case in deciding whether a restrictive practice should be prohibited as imposing an unreasonable restraint on competition.”); *White Motor Co. v. United States*, 372 U.S. 253, 261 (1963) (“[R]ule of reason’ normally requires an ascertainment of the fact peculiar to the particular business.”).

¹⁹⁶ See *White Motor Co.*, 372 U.S. at 265–66 (“To gauge the appropriateness of a per se test for the forms of restraint involved in this case, then, we must determine whether experience warrants, at this stage, a conclusion that inquiry into effect upon competition and economic justification would be similarly irrelevant.”); *GTE Sylvania Inc.*, 433 U.S. at 57 (“[V]ertical restrictions [cannot] be conclusively presumed to be unreasonable and therefore illegal without elaborate inquiry as to the precise harm they have caused or the business excuse for their use.”) (citation and internal quotation marks omitted).

¹⁹⁷ As we will see, this idea is again echoed in a later district court case, *Broad. Music, Inc. v. Moor-Law, Inc.*, 527 F. Supp. 758, 763 (D. Del. 1981), which stated that the “public goods” market is unique and therefore deserving of rule-of-reason analysis. See also *State Oil Co. v. Khan*, 522 U.S. 3, 10 (1997) (“*Per se* treatment is appropriate once experience with a particular kind of restraint enables the Court to predict with confidence that the rule of reason will condemn it. Thus, we have expressed reluctance to adopt *per se* rules with regard to restraints imposed in the context of business relationships where the economic impact of certain practices is not immediately obvious.”) (citation omitted).

¹⁹⁸ *Broad. Music, Inc. v. Columbia Broad. Sys., Inc.*, 441 U.S. 1, 19 (1979)

order to determine whether defendants' conduct was an ancillary agreement intended to increase economic efficiency.¹⁹⁹ The Court found that the "blanket license" was not a "naked restrain[t] of trade with no purpose except stifling of competition . . . but rather accompan[ied] the integration of sales, monitoring, and enforcement against unauthorized copyright use."²⁰⁰ Thus, *Broadcast Music, Inc.* instructs courts to look beyond competition to whether the arrangement creates an efficiency to which a price-restraint is ancillary. "In other words, the issue is whether the price fixing 'achieve[s] purposes unrelated to price formation.'"²⁰¹

Two later decisions also applied the rule of reason to horizontal restraints. In *National Collegiate Athletic Association v. Board of Regents of the University of Oklahoma*, members of the NCAA limited the number of college football games that could be broadcast during a given athletic season, effectively restraining "the ability of member institutions to compete in terms of price and output."²⁰² The Court once again applied an economic-effects test and considered the unique nature of the relevant market.²⁰³ It found that the quality of the NCAA's "product" (i.e., college football as a commercial product) could not be preserved "except by mutual agreement," and that the NCAA played a "vital role" in preserving

("[O]ur inquiry must focus on whether the effect and, here because it tends to show effect . . . the purpose of the practice are to threaten the proper operation of our predominantly free-market economy . . .").

¹⁹⁹ *Id.* at 20. *See also* Leslie, *supra* note 18, at 264–65 ("[T]he [*BMI*] Court acknowledged that competition is not the sole objective of the Sherman Act. Rather, there are times when competition must give way to productive efficiency concerns.").

²⁰⁰ *Broad. Music*, 441 U.S. at 20 (citation and internal quotation marks omitted).

²⁰¹ *Nat'l Bancard Corp. v. Visa U.S.A., Inc.*, 779 F.2d 592, 599 (11th Cir. 1986) (quoting *United States v. S. Motor Carriers Rate Conference, Inc.*, 672 F.2d 469, 479 (5th Cir. 1982)).

²⁰² *Nat'l Collegiate Athletic Ass'n v. Bd. of Regents of Univ. of Okla.*, 468 U.S. 85, 103 (1984).

²⁰³ *Id.* at 104 n.26 ("Per se rules may require considerable inquiry into market conditions before the evidence justifies a presumption of anticompetitive conduct.").

the integrity and character of the product.²⁰⁴ As in previous cases, the Court was guided by an interest in promoting economic efficiency.²⁰⁵ This principle appeared again in *F.T.C. v. Indiana Federation of Dentists*.²⁰⁶ Here an affiliation of dentists agreed to withhold certain records from insurance-claims examiners, who used the records to determine whether payment should be made on claims.²⁰⁷ Eventually, the Federal Trade Commission brought suit against the federation of dentists, claiming that its withholding documents amounted to “an unfair method of competition.”²⁰⁸ The Court noted that while the dentists’ conduct did resemble a “group boycott,” which the Court had in the past found “unlawful under the per se rule,” the Court here declined to apply the per se analysis.²⁰⁹ Instead, the Court employed the rule-of-reason standard²¹⁰ and, as in previous cases, held that economic efficiency may justify anticompetitive restraints.²¹¹

The prenominate cases, from *Chicago Board* to *Indiana Federation of Dentists*, support the proposition that the Supreme Court, like other federal courts, has begun to carve out an exception to the per se rule recognizing the benefit of certain horizontal price arrangements. Specifically, the Court seems more likely to apply the traditional rule of reason when a horizontal arrangement corrects a market failure in a unique industry and thus acts as an ancillary agreement intended to increase overall

²⁰⁴ *Id.* at 102. It may be easily argued that book publishers play an identical role in preserving the character and quality of their products: books. Amazon may threaten to replace publishers—but Amazon is, above all else, a consumer-goods retailer. There is much reason to doubt Amazon’s ability to produce quality books when it is more interested in selling home goods and electronics.

²⁰⁵ See Leslie, *supra* note 18, at 266 (arguing that “the Court in *NCAA* took a price-fixing scheme out of the per se category because of the potential for productive efficiency”); Piraino, *Making Sense of the Rule of Reason*, *supra* note 76, at 1758 (noting that in *NCAA* “the Supreme Court extended the rule of reason to other horizontal agreements with potential efficiency justifications”).

²⁰⁶ *F.T.C. v. Ind. Fed’n of Dentists*, 476 U.S. 447 (1986).

²⁰⁷ *Id.* at 449.

²⁰⁸ *Id.* at 451–52.

²⁰⁹ *Id.* at 457–60.

²¹⁰ *Id.* at 459.

²¹¹ See Leslie, *supra* note 18, at 266.

economic efficiency.

IV. THE APPEALS COURT SHOULD APPLY A NEW THREE-PRONG ECONOMIC-EFFECTS TEST TO *UNITED STATES V. APPLE, INC.*

As argued by Professor Leslie, the “net effect” of the prenominate decisions “is that the per se rule against horizontal price-fixing is not intact.”²¹² In conjunction with one another, these cases suggest that a horizontal price arrangement may be legal under the rule of reason when the relevant market is unique,²¹³ the restraint is ancillary to a proper agreement,²¹⁴ and when the agreement promotes economic efficiency.²¹⁵ Thus, on appeal, the U.S. Court of Appeals for the Second Circuit should evaluate *United States v. Apple, Inc.* not only under the rule of reason, but more specifically under a new three-part economic-effects test reflecting, in the most concise way possible, the above precedent. This test differs from the traditional test in two ways. First, unlike the current rule-of-reason analysis, it would be uniformly applied to instances of horizontal arrangements. Second, the new test would replace the more general inquiries of the traditional test, which typically includes “inherent nature,” “inherent effect,” and “evident purpose” prongs.²¹⁶ Under this new test, the court would instead consider whether (1) the publishing industry and e-book

²¹² *Id.* at 267.

²¹³ See *State Oil Co. v. Khan*, 522 U.S. 3, 10 (1997); *Broad Music, Inc. v. Columbia Broad Sys., Inc.*, 441 U.S. 1, 10 (1979); *Cont’l T. V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 49 (1977); *White Motor Co. v. United States*, 372 U.S. 253, 261 (1963); *Broad Music, Inc. v. Moor-Law, Inc.*, 527 F. Supp. 758, 763 (D. Del. 1981).

²¹⁴ See *Columbia Broad. Sys., Inc.*, 441 U.S. at 20; *Nat’l Bancard Corp. v. Visa U.S.A., Inc.*, 779 F.2d 592, 599 (11th Cir. 1986) (quoting *United States v. S. Motor Carriers Rate Conference, Inc.*, 672 F.2d 469, 479 (5th Cir. 1982)).

²¹⁵ See *F.T.C. v. Ind. Fed’n of Dentists*, 476 U.S. 447 (1986); *Nat’l Collegiate Athletic Ass’n v. Bd. of Regents of Univ. of Okla.*, 468 U.S. 85, 103 (1984); *Columbia Broad. Sys., Inc.*, 441 U.S. at 1; *Appalachian Coals, Inc. v. United States* 288 U.S. 344 (1933), *overruled by* *Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752 (1984); *Bd. of Trade of Chi. v. United States*, 246 U.S. 231 (1918).

²¹⁶ See *supra* notes 102–06 and accompanying text.

market are *unique or unfamiliar*; (2) the publishers' price restraint was *ancillary* to the creation of a proper agency model; and (3) the arrangement *improved efficiency* and promoted consumer welfare.²¹⁷ This standard is not derived from thin air; rather, it is a formalization of modern economics and myriad case law. Because the price-fixing arrangement between book publishers in *United States v. Apple, Inc.* satisfies these requirements, the Second Circuit should find it legal under the rule of reason.

A. Under the Sui Generis Prong the E-Book Market is Unique

Under the first prong of the proposed test, the court would determine whether the e-book market is unique. As discussed above, the Supreme Court has been reluctant to apply the per se rule when dealing with a unique economic market or an industry with which the judiciary lacks experience.²¹⁸ The Court has held

²¹⁷ HOLMES & MANGIARACINA, *supra* note 65, § 2:11.

²¹⁸ See *supra* notes 192–97 and accompanying text. See also *State Oil Co. v. Khan*, 522 U.S. 3, 10 (1997) (“Per se treatment is appropriate once experience with a particular kind of restraint enables the Court to predict with confidence that the rule of reason will condemn it. Thus, we have expressed reluctance to adopt per se rules with regard to restraints imposed in the context of business relationships where the economic impact of certain practices is not immediately obvious.”) (citation omitted); *Broad. Music, Inc. v. Columbia Broad. Sys., Inc.*, 441 U.S. 1, 10–14 (1979) (When market conditions are “*sui generis*,” the Sherman Act should be “discriminatingly applied in light of economic realities.”); *Cont’l T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 57–59 (1977) (Vertical restrictions cannot be “conclusively presumed to be unreasonable and therefore illegal without elaborate inquiry as to the precise harm they have caused or the business excuse for their use.”) (citation and internal quotation marks omitted); *White Motor Co. v. United States*, 372 U.S. 253, 265–66 (1963) (“To gauge the appropriateness of a per se test for the forms of restraint involved in this case, then, we must determine whether experience warrants, at this stage, a conclusion that inquiry into effect upon competition and economic justification would be similarly irrelevant.”); *Appalachian Coals, Inc. v. United States*, 288 U.S. 344, 361 (1933) (“It is therefore necessary in this instance to consider the economic conditions peculiar to the coal industry”), *overruled by* *Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752 (1984); *Bd. of Trade of Chi. v. United States*, 246 U.S. 231, 238 (1918) (“To determine that question the court must ordinarily consider the facts peculiar to the business to which the restraint is applied”); *Broad. Music, Inc., v. Moor-Law, Inc.*, 527

instead that when market conditions are “*sui generis*,”²¹⁹ the Sherman Act should be “discriminatingly applied in light of economic realities.”²²⁰ Because the e-book market is highly unusual, the publishers’ horizontal arrangement is best evaluated pursuant to the rule of reason. Under the rule of reason, publishers would have the opportunity to explain their rationale for a horizontal restriction on price.²²¹

The e-book market is unique for three reasons. First, e-books are “public goods” defined by two basic characteristics.²²² First, “unlike private goods (e.g., apples), one can use a public good without leaving any less for others to consume.”²²³ Because e-books are electronic files downloaded by consumers, they can be purchased and read indefinitely without ever going out of print.²²⁴ Thus, one person downloading an e-book has no effect on another’s ability to purchase the same title. In economic terms, once an e-book file is created, the marginal cost of additional consumption is near zero.²²⁵ “The second characteristic of a public good is that it is difficult to exclude persons who do not pay from using the good.”²²⁶ Just as piracy was once a critical concern for the music industry, it now threatens book publishers.²²⁷ This is largely because e-books are small files that can be downloaded

F. Supp. 758, 763–765 (D. Del. 1981) (holding that the “public goods” market is unique and therefore deserving of rule-of-reason analysis).

²¹⁹ *Columbia Broad.*, 441 U.S. at 10.

²²⁰ *Id.* at 14 (quoting Brief for United States as Amicus Curiae on Petition for Certiorari at 10–11, *K-91, Inc. v. Gershwin Pub’g Corp.*, 372 F.2d 1, 5 (9th Cir. 1967) (No. 20074)).

²²¹ Piraino, *Making Sense of the Rule of Reason*, *supra* note 76, at 1781.

²²² *Moor-Law, Inc.*, 527 F. Supp. at 763.

²²³ *Id.*

²²⁴ See Rave Uno, *Why Will eBooks Replace Traditional Books?*, BUZZLE (May 16, 2012), <http://www.buzzle.com/articles/why-ebooks-will-replace-traditional-books.html>.

²²⁵ *Cf. Moor-Law*, 527 F. Supp. at 763.

²²⁶ *Id.*

²²⁷ See Rob Reid, *What To Do When Attacked by Pirates: Music, Books and Online Piracy*, WALL ST. J. (June 1, 2012), <http://online.wsj.com/article/SB10001424052702303552104577438212250619458.html>.

easily.²²⁸ Indeed, at least one study has shown a rise in e-book piracy as the number of e-reader platforms has increased.²²⁹ Today, “[c]ountless unlicensed e-books can be found online, and millions of people use them.”²³⁰ The indefinite supply of e-books, along with low marginal costs and increasing demand for pirated files, has ramifications for the e-book market. In short, the “public goods” status of e-books means that “the natural market forces of supply and demand do not operate normally on pricing”²³¹

Second, the e-book industry is unique because e-books are not interchangeable goods. In a typical antitrust case, a market comprises products, such as widgets, that have “reasonable interchangeability.”²³² Two products are interchangeable when there is sufficient “cross-elasticity of demand”²³³—that is, when “consumers would respond to a slight increase in the price of one product by switching to another product.”²³⁴ But in the e-book market, cross-elasticity does not always exist. This is because each book publisher possesses a unique catalog of specific authors, and authors are not interchangeable.²³⁵ Unlike widgets, most authors

²²⁸ See David Carnoy, *Kindle E-book Piracy Accelerates*, CNET (Feb. 18, 2011), http://reviews.cnet.com/8301-18438_7-20033437-82.html (“E-books are small files and 2,500 of them can be packed into a single download (Torrent) that’s only about 3.4GB.”).

²²⁹ See David Carnoy, *New Study Suggests e-Book Piracy is on the Rise*, CNET (Oct. 6, 2010), http://news.cnet.com/8301-17938_105-20018831-1.html. Technology company Attributor released a second study in 2010, which indicated a fifty percent increase in online searches for pirated downloads throughout 2010, a twenty percent increase in demand for pirated downloads since the iPad became available in May 2010, and fifty-four percent increase in pirated e-book demand between August 2009 and October 2010. *Id.*

²³⁰ Reid, *supra* note 227.

²³¹ *Moor-Law, Inc.*, 527 F. Supp. at 764 (finding that the public-good status of musical compositions rendered typical supply-and-demand analysis inapplicable).

²³² *AD/SAT v. Assoc. Press*, 181 F.3d 216, 227 (2d Cir. 1999).

²³³ *Id.*

²³⁴ *Id.*

²³⁵ One might argue, of course, that there is little difference between authors of bestselling potboilers or generic legal thrillers. But such an assessment overlooks the phenomenon of “reader loyalty.” As anyone who has a favorite writer knows, there is no substitute for a unique voice. A reader

can be easily differentiated: they write books with a particular style, theme, or subject matter.²³⁶ If consumers wish to read an author's new book, they can purchase it only from the author's exclusive publisher. Should that publisher wish to increase the book's price, consumers are seldom able to purchase an "interchangeable" item from a competitor. Moreover, many readers, loyal to a particular author, would simply *prefer* to purchase a desired book at a slightly higher price than to buy another book at a slightly lower price. Again, because there is less cross-elasticity in the e-book market, the standard forces of supply and demand do not function as they would in a more elastic market.

Finally, the e-book market is unique because book publishers (manufacturers) maintain a peculiar dual-relationship with Amazon (a distributor *and* manufacturer). Beginning with its launch in 1995, Amazon has always operated as a book retailer.²³⁷ Amazon's website began by selling deeply discounted print books to its online customers.²³⁸ In November 2007, Amazon started selling e-books on its Kindle device as well.²³⁹ Throughout this period, Amazon maintained a typical—if somewhat strained—relationship with book publishers: the publishers manufactured books, and Amazon sold them. This changed in October 2011, however, when Amazon launched its own New York publishing arm.²⁴⁰ By hiring

enamored of the author George Saunders, for example, will scoff at the notion that he is "interchangeable" with another contemporary writer. This is one reason that popular authors are able to attract and maintain a loyal readership while others are not. Indeed, having a unique voice is, in large part, what makes an author marketable in the first place.

²³⁶ Works of fiction, from Homer's *Odyssey* to Joyce's *Ulysses*, are unique, inimitable artworks. Non-fiction books, too, often contain unique factual information or analysis not found elsewhere.

²³⁷ BRANDT, *supra* note 1, at 69, 82.

²³⁸ *Id.* at 82.

²³⁹ *Id.* at 139.

²⁴⁰ David Streitfeld, *Amazon Signs Up Authors, Writing Book Publishers Out of Deal*, N.Y. TIMES (Oct. 16, 2011), <http://www.nytimes.com/2011/10/17/technology/amazon-rewrites-the-rules-of-book-publishing.html> [hereinafter Streitfeld, *Amazon Signs Up Authors*]. In October 2010, before the official launch of its publishing arm, Amazon had already begun to offer royalties of

editors, wooing authors, and producing original print and e-books, Amazon became both a manufacturer and distributor.²⁴¹ Thus, operating simultaneously as the publishers' distributor and, oddly, as their competitor,²⁴² Amazon encroached on services typically provided by traditional publishers.²⁴³ This created an unprecedented set of circumstances that continues to pose an existential threat to publishers.²⁴⁴ Because Amazon is the primary

seventy “percent to authors who self-publish[ed] through the Kindle store.” BRANDT, *supra* note 1, at 144.

²⁴¹ Amazon published 122 books during its inaugural season. See Streitfeld, *Amazon Signs Up Authors*, *supra* note 240. In June 2012, the company purchased Avalon Books, a small publisher with a backlist of 3,000 titles. See Julie Bosman, *Amazon Buys Avalon Books, Publisher in Romance and Mysteries*, N.Y. TIMES (June 4, 2012, 5:46 PM), <http://mediadecoder.blogs.nytimes.com/2012/06/04/amazon-buys-avalon-books-publisher-in-romance-and-mysteries/> [hereinafter Bosman, *Amazon Buys Avalon Books*].

²⁴² The DOJ, in its Competitive Impact Statement, fails to acknowledge Amazon's dual role as retailer and manufacturer. Rather, the government treats Amazon as a pure retailer. See Competitive Impact Statement, *supra* note 10, at 13. To wit, the government proposes prohibiting publishers from retaliating should Amazon again decide to sell their e-books at a deeply discounted price. See *id.* But this is unrealistic, as Amazon is not only a retailer but a book publisher, i.e., a *direct competitor* of the settling defendants. The DOJ's prohibition is thus akin to allowing Random House to sell Macmillan's e-books at \$0.01 per copy, while depriving Macmillan of any competitive recourse. The inverse of this peculiar relationship may be seen in Amazon's strained relationship with traditional book retailers like Barnes & Noble. Now that Amazon is a publisher as well as a distributor, Barnes & Noble has begun refusing to carry Amazon's print books. See David Streitfeld, *Booksellers Resisting Amazon's Disruption*, N.Y. TIMES (Nov. 4, 2012), <http://www.nytimes.com/2012/11/05/technology/shunning-amazon-booksellers-resist-a-transformation.html> [hereinafter Streitfeld, *Booksellers Resisting*].

²⁴³ Streitfeld, *Amazon Signs Up Authors*, *supra* note 240.

²⁴⁴ One may argue that chain retailers have been doing for decades what Amazon started doing only last year. Indeed, some retail stores—e.g., Wal-mart, Whole Foods, Target—manufacture and sell their own “store brand” consumer products alongside the “name brands” manufactured by other companies. Like Amazon, these retailers wear two hats: they compete with manufacturers for market share while distributing the manufacturers' goods. There is, however, a fundamental difference between retail stores and Amazon: while store-brand tissue-paper competes against name-brand tissue-paper in an elastic market where both products are virtually interchangeable in terms of quality and

distributor of e-books, however, individual publishers have been unable to take competitive measures without jeopardizing the sales of their own books.²⁴⁵ This double-bind, unusual among economic markets, demands special attention from the court.²⁴⁶

In summary, the distinctive “public goods” status of e-books, the unusual inelasticity of e-book demand, and Amazon’s peculiar double-role as both retailer and manufacturer render the e-book market *sui generis*. It is alarming, therefore, that Judge Cote, in her Opinion & Order, declined to follow Supreme Court precedent and apply the rule of reason.²⁴⁷ Even more surprising, while Judge Cote acknowledged that *United States v. Apple, Inc.* is an unusual case,²⁴⁸ she did not require the DOJ to submit even a single economic study to support its allegations or demonstrate an adequate understanding of the market.²⁴⁹ The absence of any

ingredients, Amazon seeks to create *unique public goods* by wooing popular authors away from publishing houses. *See, e.g.*, Christine Park, *Name Brands vs. Store Brands*, ABC30 (Sept. 9, 2013), <http://abclocal.go.com/kfsn/story?id=9227042>. The stakes are much higher. Because readers are loyal to certain authors (i.e., authors are not interchangeable), and there is a finite “supply” of authors, stealing authors from a publisher constitutes a substantial blow to its business. A consumer-goods manufacturer can always improve competition by adjusting product price, marketing strategy, quality of product, etc. But a publishing house deprived of its bestselling authors—the product *itself*—can no longer compete at all. Once drained of its most valuable resource, a publisher will simply cease to exist.

²⁴⁵ When Macmillan, one of New York’s “Big Six” book publishers, first attempted to persuade Amazon to adopt an agency pricing model in early 2010, Amazon reacted by pulling all of Macmillan’s books from its Web site. *See* Brad Stone & Motoko Rich, *Amazon Removes Macmillan Books*, N.Y. TIMES (Jan. 30, 2010), <http://www.nytimes.com/2010/01/30/technology/30amazon.html>. This was clearly a competitive maneuver—aimed at injuring Macmillan—given extraordinary bite by Amazon’s status as the primary retailer of e-books.

²⁴⁶ The court ought to recognize that the publishers’ horizontal arrangement was meant to mitigate the “recognized evils” of Amazon, as the coal producers in *Appalachian Coals* were permitted to fend off the evils in the coal industry.

²⁴⁷ *United States v. Apple, Inc.*, 889 F. Supp. 2d 623, 630–41 (S.D.N.Y. 2012).

²⁴⁸ *Id.* at 634 (“Clearly, this is no ordinary Tunney Act proceeding.”).

²⁴⁹ *Id.* at 633 (acknowledging that “the Government did not submit any economic studies to support its allegations”).

financial analysis or evidentiary hearing²⁵⁰ betrays the government's lack of familiarity with the complexities of the publishing industry and the e-book market in particular. Since the e-book market is "sufficiently unusual" and the court's experience "sufficiently sparse,"²⁵¹ the circumstances of this case satisfy the first prong of the new three-part economic effects test.

B. Under the Ancillary Restraint Prong the Publishers' Horizontal Agreement is Ancillary to a Proper Agreement

Under the second prong of the proposed economic-effects test, the court would determine whether the relevant restraint is ancillary to a proper agreement. This analysis recalls Taft's decision in *Addyston Pipe*, whereby "showing that a restraint is ancillary . . . lifts it out of the per se category and subjects it to the tests of the rule of reason . . ." ²⁵² Thus, demonstrating the appropriateness of rule-of-reason analysis requires showing that the restraint is ancillary to "the main purpose of a lawful contract"²⁵³ that benefits consumers.²⁵⁴ This doctrine is easily applied to the horizontal price fixing found in *United States v. Apple, Inc.*²⁵⁵ Here, agreements between publishers to set e-book

²⁵⁰ *Id.*

²⁵¹ *Broad. Music, Inc. v. Moor-Law, Inc.* 527 F. Supp. 758, 764–65 (D. Del. 1981) (finding that when "the market is sufficiently unusual and the Court's experience with the challenged practice sufficiently sparse that one cannot confidently characterize the defendants' conduct as 'plainly anticompetitive' and very likely without 'redeeming virtue' [T]he Rule of Reason analysis is appropriate.") (citation omitted).

²⁵² BORK, *supra* note 46, at 267.

²⁵³ *United States v. Addyston Pipe & Steel Co.*, 85 F. 271, 282 (6th Cir. 1898), *aff'd as modified*, *Addyston Pipe & Steel Co. v. United States*, 175 U.S. 211 (1899).

²⁵⁴ *Id.* at 281 ("Contracts for the partial restraint of trade are upheld, not because they are advantageous to the individual with whom the contract is made, and a sacrifice pro tanto of the rights of the community, but because it is for the benefit of the public at large that they should be enforced.") (citation and internal quotation marks omitted).

²⁵⁵ *See* BORK, *supra* note 46, at 264 ("The legal doctrine necessary to the correct treatment of price-fixing and market division cases is already at hand in

prices would be harmful unless ancillary to another end.²⁵⁶ More specifically, it would be illegal per se to set e-book prices “only when the restraint is ‘naked’—that is, only when the agreement is not ancillary to cooperative productive activity engaged in by the agreeing parties.”²⁵⁷ As we will see, the horizontal agreement between publishers was entirely ancillary to a lawful and productive vertical arrangement, the agency pricing model.

There is no question that publishers engaged in a horizontal agreement in order to establish an agency pricing model. The clearest indication of this is that Macmillan attempted to negotiate the agency model with Amazon *before* any collusive steps were taken by the rest of the publishers.²⁵⁸ This suggests that the publishers’ only aim was to establish a legal pricing system, rather than to arbitrarily raise e-book prices and increase revenue.²⁵⁹ Moreover, both the DOJ and Judge Cote acknowledge that the alleged “collusion” between publishers was a means to establish agency pricing with retailers.²⁶⁰ Indeed, the government offers no evidence of further collusion once the agency model was set in place in January 2010. It is clear, therefore, that here, as in *Broadcast Music*, the horizontal arrangement between defendants was ancillary to a single and proper purpose.²⁶¹

the concept of ancillary restraints.”).

²⁵⁶ HOLMES & MANGIARACINA, *supra* note 65, § 2:9.

²⁵⁷ BORK, *supra* note 46, at 262.

²⁵⁸ See Stone & Rich, *supra* note 245.

²⁵⁹ Indeed, certain commentators have noted that book publishers likely made *less* per book under the agency model. As Adam C. Engst has pointed out, overall earnings might have dropped by “as much as seventeen percent.” Adam C. Engst, *Explaining the Apple Ebook Price Fixing Suit*, TIDBITS (July 10, 2013), <http://tidbits.com/article/13912> (“Consider a \$29.99 hardcover that Apple would sell for \$14.99. The publisher would earn 70 percent of that, or roughly \$10.50. But under the wholesale model, the publisher might have sold that book to Amazon for as much as \$15.”)

²⁶⁰ See *United States v. Apple, Inc.*, 889 F. Supp. 2d 623, 632 (S.D.N.Y. 2012) (noting that “the Complaint alleges unlawful communications and industry collusion that gave rise to a series of agreements designed to ensure defendants’ use of agency pricing for e-books . . .”).

²⁶¹ *Broad. Music, Inc. v. Columbia Broad. Sys., Inc.*, 441 U.S. 1, 19 (1979) (finding that a blanket license was not a “naked restrain[t] of trade with no

The agency model adopted by publishers is completely legal. The Supreme Court has long recognized the validity of vertical price maintenance, despite the confusion caused by *Dr. Miles*.²⁶² As discussed above, the *Leegin* court officially overruled *Dr. Miles*, finding that vertical retail-price maintenance often has pro-competitive benefits.²⁶³ Vertical arrangements have since become difficult to prove illegal, and are often viewed by the courts as legal.²⁶⁴ Even the government contends that it “does not object to the agency method of distribution in the e-book industry”²⁶⁵ Moreover, actual price maintenance cannot be said to exist when prices are established through a valid agency relationship,²⁶⁶ which is the case in *United States v. Apple, Inc.*

*C. Under the Efficiency Prong the Horizontal Agreement
Creates Economic Efficiency in the E-book Market*

Under the third prong of the proposed economic-effects test, the court would consider what, if any, effects a business restraint has on economic efficiency in a particular market. As discussed earlier in Part II.B,²⁶⁷ market efficiency is the true measure of antitrust policy. Just as procompetitive restraints were once presumed legal, courts should recognize “a presumption in favor of the legality of those restraints that usually promote efficiency.”²⁶⁸

purpose except stifling of competition . . . but rather accompanies the integration of sales, monitoring, and enforcement against unauthorized copyright use”) (citation and internal quotation marks omitted).

²⁶² See, e.g., *United States v. Gen. Elec. Co.*, 272 U.S. 476, 488 (1926) (“We are of opinion, therefore, that there is nothing as a matter of principle or in the authorities which requires us to hold that genuine contracts of agency like those before us, however comprehensive as a mass or whole in their effect, are violations of the Anti-Trust Act.”).

²⁶³ See *supra* Part I.B; see also *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 551 U.S. 877, 895 (2007).

²⁶⁴ See KESSLER & WALLER, *supra* note 48.

²⁶⁵ Response of Plaintiff United States to Public Comments, *supra* note 43, at 7.

²⁶⁶ See KESSLER & WALLER, *supra* note 48.

²⁶⁷ See *supra* Part II.B.

²⁶⁸ Piraino, *Making Sense of the Rule of Reason*, *supra* note 76, at 1755. A

At the very least, defendants must be given an opportunity to present a plausible efficiency defense by showing that a business restraint increases efficiency.²⁶⁹ Therefore, the courts' task when evaluating such a restraint is to distinguish between arrangements that diminish efficiency and those that promote it.²⁷⁰ The horizontal retail-price agreement, as it was implemented by book publishers in April 2010, promoted efficiency in the e-book market.²⁷¹ The publishers, therefore, should have the opportunity to explain their case in court.²⁷²

Publishers acted to correct a problem wrought by Amazon, which created inefficiency by monopolizing the e-book market. "The offense of monopoly under Section 2 of the Sherman Act has two elements: (1) the possession of monopoly power in the relevant market and (2) the willful acquisition or maintenance of that power as distinguished from growth or development as a consequence of a superior product, business acumen, or historic accident."²⁷³

First, Amazon possessed monopoly powers in the relevant market. It is undisputed that before the advent of the agency model, Amazon enjoyed a ninety-percent share of the e-book market,²⁷⁴ a fact which the government omits from both its

presumption of reasonableness is nothing new; in fact, it harkens back to Justice Brandeis's opinion in *Board of Trade of City of Chicago v. United States*, 246 U.S. 231, 238 (1918). Justice Brandeis observed that "[e]very agreement concerning trade, every regulation of trade, restrains. To bind, to restrain, is of their very essence. The true test of legality is whether the restraint imposed is such as merely regulates and perhaps thereby promotes competition or whether it is such as may suppress or even destroy competition." *Id.*

²⁶⁹ Leslie, *supra* note 18, at 267. See also *In re Mass. Bd. of Registration in Optometry*, 110 F.T.C. 549, 604 (1988) ("[A] defense is plausible if it cannot be rejected without extensive factual inquiry.").

²⁷⁰ Piraino, *Making Sense of the Rule of Reason*, *supra* note 76, at 1768.

²⁷¹ See *id.* at 1780.

²⁷² See *id.*

²⁷³ *United States v. Grinnell Corp.*, 384 U.S. 563, 570–71 (1966).

²⁷⁴ See, e.g., Comments of Barnes & Noble, Inc. on the Proposed Final Judgment at 9, *United States v. Apple, Inc.*, 889 F. Supp. 2d 623 (S.D.N.Y. 2012) (No. 12 Civ. 2826); Hiltzick, *supra* note 14; Maher, *supra* note 12; Phillips, *supra* note 14.

briefs.²⁷⁵ The predominant size of Amazon's market share was a clear indication of its monopoly power in the e-book market.²⁷⁶

Second, Amazon maintained its market power through illegal methods—namely, predatory pricing. The Second Circuit has held that “[t]he relationship between a firm’s prices and its marginal costs provides the best single determinate of predatory pricing.”²⁷⁷ Thus, contrary to the DOJ’s opinion, abundant evidence shows that Amazon was indeed guilty of predatory pricing before the advent of the agency model.²⁷⁸ Beginning with the launch of the Kindle in

²⁷⁵ The government appears completely unwilling to admit that by 2010, Amazon had monopolized the e-book market. Its contention that returning price discretion back to retailers will “allow competition to return to the market” therefore strains credulity. See Competitive Impact Statement, *supra* note 10, at 12. That there was no competition before the agency model is obvious to anyone who examines the data. Moreover, any competition in the market today was a direct result of publishers ensuring that e-book prices remain remunerative, encouraging other retailers, like Barnes & Noble and Apple, to enter the market.

²⁷⁶ See, e.g., *Grinnell*, 384 U.S. at 571 (finding that an eighty-seven percent market share constituted “monopoly power”); *Am. Tobacco Co. v. United States*, 328 U.S. 781, 797 (1946) (finding that “over two-thirds” of the entire cigarette market constituted a “substantial monopoly”); *United States v. Aluminum Co. of Am.*, 148 F.2d 416, 429 (1945) (finding that a ninety percent market share constituted market power).

²⁷⁷ *Ne. Tel. Co. v. Am. Tel. & Tel. Co.*, 651 F.2d 76, 88 (2d Cir. 1981).

²⁷⁸ See BORK, *supra* note 46, at 144.

Predation may be defined, provisionally, as a firm’s deliberate aggression against one or more rivals through the employment of business practices that would not be considered profit maximizing except for the expectation either that (1) rivals will be driven from the market, leaving the predator with a market share sufficient to command monopoly profits, or (2) rivals will be chastened sufficiently to abandon competitive behavior the predator finds inconvenient or threatening.” It is clear that Amazon’s pricing practices meet both requirements. Moreover, Amazon was in a unique position to subsidize low returns in the e-book market with higher returns in its profitable consumer-goods sales, thus giving it the ability to sell e-books at cut-rate prices for an indefinite period of time.

Id.; see also Phillip Areeda & Donald F. Turner, *Predatory Pricing and Related Practices Under Section 2 of the Sherman Act*, 88 HARV. L. REV. 697, 721

2007, Amazon sold e-books to consumers at a considerable loss.²⁷⁹ Under the wholesale model, publishers sold copies of print- and e-books to Amazon for roughly fifty percent of the list price of the printed edition.²⁸⁰ Amazon then offered many e-books—especially new releases and *New York Times* bestsellers—to consumers for a “cut-rate” price of \$9.99.²⁸¹ Thus, an e-book with a list price of \$26.00 would be sold to Amazon for \$13.00; Amazon in turn sold the title to consumers for \$9.99—a marginal loss of \$3.00.²⁸² Other sources estimate that Amazon lost as much as \$4.00 or \$5.00 on every e-book it sold.²⁸³ Either way, assuming that Amazon’s marginal cost was no less than the wholesale cost of an e-book, it is clear that Amazon was pricing e-books well below marginal cost.²⁸⁴ Accordingly, pursuant to Second Circuit precedent, Amazon was clearly engaging in predatory pricing.²⁸⁵ Amazon also preserved its market power in a number of other questionable ways, including retaliating against publishers that attempted to take advantage of other e-books platforms; removing the online “buy” buttons for titles from publishers that did not agree to Amazon’s

(1975).

²⁷⁹ Maher, *supra* note 12 (estimating that Amazon lost \$35 million on e-book sales through October 2009); *see also* Brief of Bob Kohn, *supra* note 11, at 21; BRANDT, *supra* note 1, at 142. The government’s contention that “Amazon’s e-book distribution business has been consistently profitable” is inexplicable, as it is supported by neither economic analysis nor simple common sense. *See, e.g.*, Complaint, *supra* note 3, at 9. Moreover, profitability is not relevant in a predatory-pricing analysis because it is not a proper indication of efficiency. *See* BORK, *supra* note 46, at 106 (arguing that efficiency “is not a concept coterminous with profitability. A firm may be profitable because it forms a cartel, merges to monopolistic size, or employs predatory tactics successfully. Profitability based upon such tactics is not evidence of productive efficiency because consumer welfare is lessened rather than increased. Profitability in such cases is based upon the disruption of allocative efficiency rather than the enhancement of productive efficiency.”).

²⁸⁰ Competitive Impact Statement, *supra* note 10, at 3.

²⁸¹ *Id.*; *see also* BRANDT, *supra* note 1, at 142; Lacy, *supra* note 10.

²⁸² Brief of Bob Kohn, *supra* note 11, at 21.

²⁸³ BRANDT, *supra* note 1, at 142; Lacy, *supra* note 10.

²⁸⁴ Brief of Bob Kohn, *supra* note 11, at 22.

²⁸⁵ *Ne. Tel. Co. v. Am. Tel. & Tel. Co.*, 651 F.2d 76, 88 (1981) (“[P]rices below reasonably anticipated marginal cost will be presumed illegal.”).

contractual terms; and pursuing exclusive distribution agreements with authors.²⁸⁶

According to adherents of the Chicago School, the real problem with Amazon's e-book monopoly was that it caused inefficiency.²⁸⁷ This is because the monopolist creates "a gap between marginal cost and price, which means that social costs and social desires are no longer equated."²⁸⁸ By selling e-books at unremunerative prices, Amazon prevented rivals from entering the market and thereby stifled efficiency-creating innovation.²⁸⁹ More importantly, Amazon's predatory pricing led to a market failure that caused overconsumption of e-books.²⁹⁰ Because e-books were sold at artificially low prices, more of them were purchased than could be efficiently produced.²⁹¹ When viewed from a purely economic perspective, then, the publishers' anxiety over "the \$9.99 problem" was entirely justified. Publishers were not simply worried about protecting their own profits; rather, as the Second Circuit has recognized, the type of predatory pricing perpetrated by Amazon, and its resultant inefficiency, directly threatened

²⁸⁶ *United States v. Apple, Inc.*, 889 F. Supp. 2d 623, 639 (S.D.N.Y. 2012).

²⁸⁷ Leslie, *supra* note 18, at 250. See also BORK, *supra* note 46, at 101.

²⁸⁸ BORK, *supra* note 46, at 101 ("The evil of monopoly, then, is not higher prices or smaller production (though these are its concomitants) but misallocated resources, or allocation inefficiency.").

²⁸⁹ See Areeda & Turner, *supra* note 278, at 698. Indeed, the DOJ recognizes that Apple was unable to enter the e-book market before the advent of the agency model because e-book prices were prohibitively low. This was not, as the DOJ claims, due to the "intense price competition that prevailed among e-book retailers in late 2009"—competition that did not exist given that Amazon held 90 percent of the market. See Complaint, *supra* note 3, at 3. Rather, it was due entirely to Amazon's illegal predatory pricing, which also deterred other competitors, like Google, Barnes & Noble, and Zola Books from entering the market. *Apple, Inc.*, 889 F. Supp. 2d at 639.

²⁹⁰ See Leslie, *supra* note 18, at 268.

²⁹¹ The DOJ betrays a lack of economic understanding when it asserts that publishers' agency model "prevented e-book retailers from experimenting with innovative pricing strategies that could efficiently respond to consumer demand." Competitive Impact Statement, *supra* note 10, at 9. In fact, it was the publishers' agreement that *corrected* the supply-demand curve by returning consumption to an efficient level.

consumer welfare.²⁹²

The book publishers in *United States v. Apple, Inc.* acted efficiently (and legally) by correcting the market failure caused by Amazon's predatory pricing of e-books.²⁹³ In order to understand why the publishers' price-fixing arrangement was efficient, we must briefly consider the economic theory of the second best. According to Professors Lipsey and Lancaster in their seminal work on the matter, the general theory of the second best states that if optimal conditions of efficiency cannot be fulfilled, "a second best optimum situation is achieved only by departing from all other optimum conditions."²⁹⁴ When there is a monopoly constraint on output, for instance, further constraints may be required to achieve a desirable situation.²⁹⁵ The theory of the second best thus suggests that if two market failures occur in a market and the government cannot resolve both of them, "it may be more efficient to leave the market unregulated despite the failures."²⁹⁶ In other words, the theory of the second best turns on its head the old apothegm that two wrongs don't make a right.²⁹⁷ By suggesting that, in the context of the e-book market, two wrongs *can* make a right, this theory effectively rebuts the DOJ's contention that horizontal price-fixing is per se illegal even if it leads to an optimum situation.²⁹⁸ The theory of the second best also casts doubt on Judge Cote's observation that "[t]he familiar mantra regarding 'two wrongs' would seem to offer guidance in these circumstances."²⁹⁹

The theory of the second best holds that "[i]f two market

²⁹² See *Ne. Tel. Co. v. Am. Tel. & Tel. Co.*, 651 F.2d 76, 87 (2d Cir. 1981).

²⁹³ See *United States v. Int'l Bus. Mach. Corp.*, 163 F.3d 737, 741–42 (2d Cir. 1998) ("The purpose of the [Sherman] Act is not to protect businesses from the working of the market; it is to protect the public from the failure of the market.") (quoting *Spectrum Sports v. McQuillan*, 506 U.S. 447, 458 (1993)).

²⁹⁴ Lipsey & Lancaster, *supra* note 57, at 48.

²⁹⁵ *Id.* at 49.

²⁹⁶ Leslie, *supra* note 18, at 268.

²⁹⁷ *Id.*

²⁹⁸ See Response of Plaintiff United States to Public Comments, *supra* note 43, at 7.

²⁹⁹ *United States v. Apple, Inc.*, 889 F. Supp. 2d 623, 642 (S.D.N.Y. 2012).

failures exist simultaneously[,] one causing underconsumption and one causing overconsumption,” the failures will “balance each other and create a more efficient equilibrium than if antitrust enforcement eliminated only one market failure.”³⁰⁰ In this case, book publishers created a market failure—by promoting underconsumption of e-books—to counteract the original market failure caused by Amazon. Because the DOJ declined to uphold optimum conditions by addressing the original Amazon market failure, publishers were left to re-establish efficiency by their own means, which included both vertical and horizontal pricing arrangements³⁰¹ that eliminated monopolistic predatory pricing and allowed competition in the market. This conduct was completely legal under the Sherman Act, which is meant to eliminate inefficiencies in the market thereby promoting consumer welfare.³⁰² Indeed, the publishers’ actions corrected the Amazon market failure, maximized efficiency, and therefore promoted the true goal of the Sherman Act: the promotion of consumer welfare.³⁰³

³⁰⁰ Leslie, *supra* note 18, at 268–69. Leslie argues that “[a]ccording to the theory of the second best, when other market failures are also present the various failures may cancel each other out, so that nonenforcement of antitrust laws maximizes efficiency.” *Id.* at 244.

³⁰¹ To her credit, Judge Cote briefly acknowledged the possibility that Apple and the publishers were merely responding to the predatory pricing initiated by Amazon. However, by denying the Defendants an opportunity to explain the situation, Judge Cote cleaved too closely to the *per se* rule. *See United States v. Apple, Inc.*, No. 12 Civ. 2826, 2013 WL 3454986 at *58 (S.D.N.Y. July 10, 2013) (“If Apple is suggesting that Amazon was engaging in illegal, monopolistic practices, and that Apple’s combination with the Publisher Defendants to deprive a monopolist of some of its market power is pro-competitive and healthy for our economy, it is wrong. This trial has not been the occasion to decide whether Amazon’s choice to sell NYT Bestsellers or other New Releases as loss leaders was an unfair trade practice or in any other way a violation of law. If it was, however, the remedy for illegal conduct is a complaint lodged with the proper law enforcement offices or a civil suit or both.”).

³⁰² Leslie, *supra* note 18, at 250.

³⁰³ *Id.* at 283.

CONCLUSION

By disregarding the true purpose of the Sherman Act, the District Court in *United States v. Apple, Inc.* did a profound disservice not only to the book-publishing industry, but to antitrust law at large. The court accomplished the very opposite of good policy: it chastened Apple and the publishers for seeking to restore efficiency to the e-book market, while permitting Amazon to re-exert its monopolistic dominance through a return to predatory pricing. Yet there is still hope that the initial decision in *United States v. Apple, Inc.* represents a preamble to a happier, more satisfying story. The Second Circuit—and perhaps even the U.S. Supreme Court—will have an opportunity to rewrite the fate of the burgeoning e-book industry.

In re-examining the business arrangements at the heart of *United States v. Apple, Inc.*, the higher courts ought not only to extend the rule of reason to the horizontal arrangements in this case (as the lower court failed to do), but apply an improved three-prong economic-effects test based on a contemporary understanding of economics. The courts should thus consider whether (1) the publishing industry and e-book markets are unique or unfamiliar; (2) the publishers' price restraint was ancillary to the creation of a proper agency model; and (3) the arrangement improved efficiency and promoted consumer welfare. By applying this nuanced analysis, the higher courts will best advance the interests of the public and ensure that justice is served. Thus, while the first chapter of this story is complete, the book is far from finished.