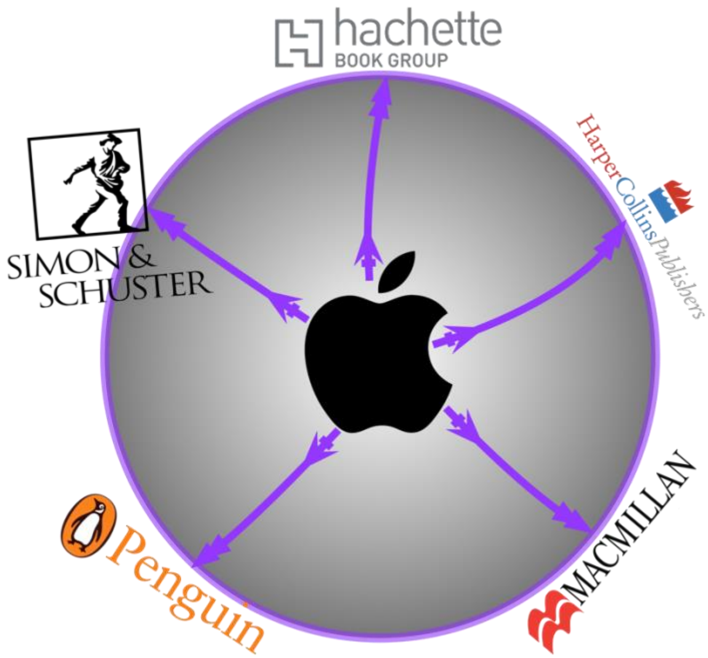
ANTITRUST
COMPETITION POLICY & TRUSTBUSTING



United States v. Apple, Inc.

791 F.3d 290 (2d Cir. 2015)

DEBRA ANN LIVINGSTON, Circuit Judge.

Since the invention of the printing press, the distribution of books has involved a fundamentally consistent process: compose a manuscript, print and bind it into physical volumes, and then ship and sell the volumes to the public. In late 2007, Amazon.com, Inc. ("Amazon") introduced the Kindle, a portable device that carries digital copies of books, known as "ebooks." This innovation had the potential to change the centuries-old process for producing books by eliminating the need to print, bind, ship, and store them. Amazon began to popularize the new way to read, and encouraged consumers to buy the Kindle by offering desirable books—new releases and New York Times bestsellers—for $9.99. Publishing companies, which have traditionally stood at the center of the multi-billion dollar book-producing industry, saw Amazon's ebooks, and particularly its $9.99 pricing, as a threat to their way of doing business.

By November 2009, Apple, Inc. ("Apple") had plans to release a new tablet computer, the iPad. Executives at the company saw an opportunity to sell ebooks on the iPad by creating a virtual marketplace on the device, which came to be known as the "iBookstore." Working within a tight timeframe, Apple went directly into negotiations with six of the major publishing companies in the United States. In two months, it announced that five of those companies—Hachette, HarperCollins, Macmillan, Penguin, and Simon & Schuster (collectively, the "Publisher Defendants")—had agreed to sell ebooks on the iPad under arrangements whereby the publishers had the authority to set prices, and could set the prices of new releases and New York Times bestsellers as high as $19.99 and $14.99, respectively. Each of these agreements, by virtue of its terms, resulted in each Publisher Defendant receiving less per ebook sold via Apple as opposed to Amazon, even given the higher consumer prices. Just a few months after the iBookstore opened, however, every one of the Publisher Defendants had taken control over pricing from Amazon and had raised the prices on many of their ebooks, most notably new releases and bestsellers.

The United States Department of Justice ("DOJ" or "Justice Department") and 33 states and territories (collectively, "Plaintiffs") filed suit in the United States District Court for the Southern District of New York, alleging that Apple, in launching the iBookstore, had conspired with the Publisher Defendants to raise prices across the nascent ebook market. This agreement, they argued, violated § 1 of the Sherman Antitrust Act, and state antitrust laws.

All five Publisher Defendants settled and signed consent decrees, which prohibited them, for a period, from restricting ebook retailers' ability to set prices. Then, after a three-week bench trial, the district court concluded that, in order to induce the Publisher Defendants to participate in the iBookstore and to avoid the necessity of itself competing with Amazon over the retail price of ebooks, Apple orchestrated a conspiracy among the Publisher Defendants to raise the price of ebooks—particularly new releases and New York Times bestsellers. *United States v. Apple Inc.*, 952 F.Supp.2d 638, 647 (S.D.N.Y. 2013). The district court found that the agreement constituted a *per se* violation of the Sherman Act and, in the alternative, unreasonably restrained trade under the rule of reason.

On September 5, 2013, the district court entered final judgment on the liability finding and issued an injunctive order that, *inter alia*, prevents Apple from entering into agreements with the Publisher Defendants that restrict its ability to set, alter, or reduce the price of ebooks, and requires Apple to apply the same terms and conditions to ebook applications sold on its devices as it does to other applications.

On appeal, Apple contends that the district court's liability finding was erroneous. . . . We conclude that the district court's decision that Apple orchestrated a horizontal conspiracy among the Publisher Defendants to raise ebook prices is amply supported and well-reasoned, and that the agreement unreasonably restrained trade in violation of § 1 of the Sherman Act. We also conclude that the district court's injunction is lawful and consistent with preventing future anticompetitive harms.

. . . Because we conclude that the district court did not err in deciding that Apple violated § 1 of the Sherman Act, and because we also conclude that the district court's injunction was lawful and consistent with preventing future anticompetitive harms, we affirm.

BACKGROUND

I. Factual Background

. . . In the United States, the six largest publishers of trade books, known in the publishing world as the "Big Six," are Hachette, HarperCollins, Macmillan, Penguin, Random House, and Simon & Schuster. Together, the Big Six publish many of the biggest names in fiction and non-fiction; during 2010, their titles accounted for over 90% of the New York Times bestsellers in the United States. . . .

For decades, trade book publishers operated under a fairly consistent business model. When a new book was ready for release to the public, the publisher would sell hardcover copies to retailers at a "wholesale" price and recommend resale to consumers at a markup, known as the "list" price. After the hardcover spent enough time on the shelves—often a year—publishers would release a paperback copy at lower "list" and "wholesale" prices. In theory, devoted readers would pay the higher hardcover price to read the book when it first came out, while more casual fans would wait for the paperback.

A. Amazon's Kindle

On November 19, 2007, Amazon released the Kindle: a portable electronic device that allows consumers to purchase, download, and read ebooks. At the time, there was only one other ereader available in the emerging ebook market, and Amazon's Kindle quickly gained traction. In 2007, ebook revenue in North America was only $70 million, a tiny amount relative to the approximately $30 billion market for physical trade books. The market was growing, however; in 2008 ebook revenue was roughly $140 million and, by the time Barnes & Noble, Inc. (Barnes & Noble) launched its Nook ereader in November 2009, Amazon was responsible for 90% of all ebook sales.

Amazon followed a "wholesale" business model similar to the one used with print books: publishers recommended a digital list price and received a wholesale price for each ebook that Amazon sold. In exchange, Amazon could sell the publishers' ebooks on the Kindle and determine the retail price. At least early on, publishers tended to recommend a digital list price that was about 20% lower than the print list price to reflect the fact that, with an ebook, there is no cost for printing, storing, packaging, shipping, or returning the books.

Where Amazon departed from the publishers' traditional business model was in the sale of new releases and New York Times bestsellers. Rather than selling more expensive versions of these books upon initial release (as publishers encouraged by producing hardcover books before paperback copies), Amazon set the Kindle price at one, stable figure—$9.99. At this price, Amazon was selling "certain" new releases and bestsellers at a price that "roughly matched," or was slightly lower than, the wholesale price it paid to the publishers. David Naggar, a Vice President in charge of Amazon's Kindle content, described this as a "classic loss-leading strategy" designed to encourage consumers to adopt the Kindle by discounting new releases and New York Times bestsellers and selling other ebooks without the discount. . . .

B. The Publishers' Reactions

Despite the small number of ebook sales compared to the overall market for trade books, top executives in the Big Six saw Amazon's $9.99 pricing strategy as a threat to their established way of doing business. . . .

In the short term, [the CEOs] of the Big Six thought that Amazon's lower-priced ebooks would make it more difficult for them to sell hardcover copies of new releases, "which were often priced," as the district court noted, "at thirty dollars or more," as well as New York Times bestsellers. Further down the road, the publishers feared that consumers would become accustomed to the uniform $9.99 price point for these ebooks, permanently driving down the price they could charge for print versions of the books. Moreover, if Amazon became powerful enough, it could demand lower wholesale prices from the Big Six or allow authors to publish directly with Amazon, cutting out the publishers entirely. As Hachette's Young put it, the idea of the "wretched $9.99 price point becoming a de facto standard" for ebooks "sickened" him.

The executives of the Big Six also recognized that their problem was a collective one. Thus, an August 2009 Penguin strategy report (concluded only a few months before Apple commenced its efforts to launch the iBookstore) noted that "[c]ompetition for the attention of readers will be most intense from digital companies whose objective may be to [cut out] traditional publishers altogether.... It will not be possible for any individual publisher to mount an effective response, because of both the resources necessary and the risk of retribution, so the industry needs to develop a common strategy." Similarly, Reidy from Simon & Schuster opined in September 2009 that the publishers had "no chance of success in getting Amazon to change its pricing practices" unless they acted with a "critical mass," and expressed the "need to gather more troops and ammunition" before implementing a move against Amazon.

Conveniently, the Big Six operated in a close-knit industry and had no qualms communicating about the need to act together. As the district court found (based on the Publisher Defendants' own testimony), "[o]n a fairly regular basis, roughly once a quarter, the CEOs of the [Big Six] held dinners in the private dining rooms of New York restaurants, without counsel or assistants present, in order to discuss the common challenges they faced." Because they "did not compete with each other on price," but over authors and agents, the publishers "felt no hesitation in freely discussing Amazon's prices with each other and their joint strategies for raising those prices." Those strategies included eliminating the discounted wholesale price for ebooks and possibly creating an alternative ebook platform.

The most significant attack that the publishers considered and then undertook, however, was to withhold new and bestselling books from Amazon until the hardcover version had spent several months in stores, a practice known as "windowing." Members of the Big Six both kept one another abreast of their plans to window, and actively pushed others toward the strategy. By December 2009, the *Wall Street Journal* and *New York Times* were reporting that four of the Big Six had announced plans to delay ebook releases until after the print release, and the two holdouts—Penguin and Random House—faced pressure from their peers.

Ultimately, however, the publishers viewed even this strategy to save their business model as self-destructive. Employees inside the publishing companies noted that windowing encouraged piracy, punished ebook consumers, and harmed long-term sales. . . .

C. Apple's Entry Into the Ebook Market

Apple is one of the world's most innovative and successful technology companies. Its hardware sells worldwide and supports major software marketplaces like iTunes and the App Store. But in 2009, Apple lacked a dedicated marketplace for ebooks or a hardware device that could offer an outstanding reading experience. The pending release of the iPad, which Apple intended to announce on January 27, 2010, promised to solve that hardware deficiency.

Eddy Cue, Apple's Senior Vice President of Internet Software and Services and the director of Apple's digital content stores, saw the opportunity for an ebook marketplace on the iPad. . . . While Amazon had an estimated 90% market share in trade ebooks, Cue believed that Apple could become a powerful player in the market in large part because consumers would be able to do many tasks on the iPad, and would not want to carry a separate Kindle for reading alone. In an email to Apple's then-CEO, Steve Jobs, he discussed the possibility of Amazon selling ebooks through an application on the iPad, but felt that "it would be very easy for [Apple] to compete with and ... trounce Amazon by opening up our own ebook store" because "[t]he book publishers would do almost anything for [Apple] to get into the ebook business."

Jobs approved Cue's plan for an ebook marketplace—which came to be known as the iBookstore—in November 2009. Although the iPad would go to market with or without the iBookstore, Apple hoped to announce the ebook marketplace at the January 27, 2010 iPad launch to "ensure maximum consumer exposure" and add another "dramatic component" to the event. This left Cue and his team only two months amidst the holiday season both to create a business model for the iBookstore and to assemble a group of publishers to participate. Cue also had personal reasons to work quickly. He knew that Jobs was seriously ill, and that, by making the iBookstore a success, he could help Jobs achieve a longstanding goal of creating a device that provides a superior reading experience.

Operating under a tight timeframe, Cue [and colleagues] streamlined their efforts by focusing on the Big Six publishers. They began by arming themselves with some important information about the state of affairs within the publishing industry. In particular, they learned that the publishers feared that Amazon's pricing model could change their industry, that several publishers had engaged in simultaneous windowing efforts to thwart Amazon, and that the industry as a whole was in a state of turmoil. "Apple understood," as the district court put it, "that the Publishers wanted to pressure Amazon to raise the $9.99 price point for e-books, that the Publishers were searching for ways to do that, and that they were willing to coordinate their efforts to achieve that goal." For its part, as the district court found, Apple was willing to sell ebooks at higher prices, but "had decided that it would not open the iBookstore if it could not make money on the store and compete effectively with Amazon."

D. Apple's Negotiations with the Publishers

1. Initial Meetings

Apple held its first meetings with each of the Big Six between December 15 and 16. The meetings quickly confirmed Cue's suspicions about the industry. . . . Apple informed each of the Big Six that it was negotiating with the other major publishers, that it hoped to begin selling ebooks within the next 90 days, and that it was seeking a critical mass of participants in the iBookstore and would launch only if successful in reaching this goal. Apple informed the publishers that it did not believe the iBookstore would succeed unless publishers agreed both not to window books and to sell ebooks at a discount relative to their physical counterparts. Apple noted that ebook prices in the iBookstore needed to be comparable to those on the Kindle. . . . Most importantly for the publishers, however, Cue's team also expressed Apple's belief that Amazon's $9.99 price point was not ingrained in consumers' minds, and that Apple could sell new releases and *New York Times* bestsellers for somewhere between $12.99 and $14.99. In return, Apple requested that the publishers decrease their wholesale prices so that the company could make a small profit on each sale.

These meetings spurred a flurry of communications reporting on the ["terrific news," as described in emails among the CEOs of the Big Six]. . . . Significantly, these communications included numerous exchanges between executives at different Big Six publishers who, the district court found, "hashed over their meetings with Apple with one another." The district court found that the frequent telephone calls among the Publisher Defendants during the period of their negotiations with Apple "represented a departure from the ordinary pattern of calls among them."

2. The Agency Model

Meanwhile, Cue [and colleagues] . . . remained concerned about whether the publishers would reduce wholesale prices on new releases and bestsellers by a large enough margin to allow Apple to offer competitive prices and still make a profit. . . . As Cue saw it, Apple's most valuable bargaining chip came from the fact that the publishers were desperate "for an alternative to Amazon's pricing policies." . . .

It was at this point that Cue's team, recognizing its opportunity, abandoned the wholesale business model for a new, agency model. Unlike a wholesale model, in an agency relationship the publisher sets the price that consumers will pay for each ebook. Then, rather than the retailer paying the publisher for each ebook that it sells, the publisher pays the retailer a fixed percentage of each sale. In essence, the retailer receives a commission for distributing the publisher's ebooks. Under the system Apple devised, publishers would have the freedom to set ebook prices in the iBookstore, and would keep 70% of each sale. The remaining 30% would go to Apple as a commission.

This switch to an agency model obviated Apple's concerns about negotiating wholesale prices with the Big Six while ensuring that Apple profited on every sale. It did not, however, solve all of the company's problems. Because the agency model handed the publishers control over pricing, it created the risk that the Big Six would sell ebooks in the iBookstore at far higher prices than Kindle's $9.99 offering. If the prices were too high, Apple could be left with a brand new marketplace brimming with titles, but devoid of customers.

To solve this pricing problem, Cue's team initially devised two strategies. First, they realized that they could maintain "realistic prices" by establishing price caps for different types of books. Of course, these caps would need to be *higher* than Amazon's $9.99 price point, or Apple would face the same difficult price negotiations that it sought to avoid by switching away from the wholesale model. But at this point Apple was not content to open its iBookstore offering prices higher than the competition. For as the district court found, if the Publisher Defendants "wanted to end Amazon's $9.99 pricing," Apple similarly desired "that there be no price competition at the retail level."

[To eliminate retail price competition], . . . rather than simply agreeing to price caps above Amazon's $9.99 price point, Apple created a second requirement: publishers must switch all of their other ebook retailers—including Amazon—to an agency pricing model. The result would be that Apple would not need to compete with Amazon on price, and publishers would be able to eliminate Amazon's $9.99 pricing. . . .

On January 4 and 5, Apple sent essentially identical emails to each member of the Big Six to explain its agency model proposal. Each email described the commission split between Apple and the publishers and recommended three price caps: $14.99 for hardcover books with list prices above $35; $12.99 for hardcover books with list prices below $35; and $9.99 for all other trade books. The emails also explained that, "to sell ebooks at realistic prices ... all [other] resellers of new titles need to be in [the] agency model." Or, as Cue told Reidy, "all publishers" would need to move "all retailers" to an agency model.

3. The "Most–Favored–Nation" Clause

Cue's thoughts on the agency model continued to evolve after the emails on January 4 and 5. Most significantly, [an] in-house counsel devised an alternative to explicitly requiring publishers to switch other retailers to agency. This alternative involved the use of a "most-favored nation" clause ("MFN Clause" or "MFN").

In general, an MFN Clause is a contractual provision that requires one party to give the other the best terms that it makes available to any competitor. In the context of Apple's negotiations, . . . the MFN would require the publisher to offer any ebook in Apple's iBookstore for no more than what the same ebook was offered elsewhere, such as from Amazon.

On January 11, Apple sent each of the Big Six a proposed eBook Agency Distribution Agreement (the "Contracts"). As described in the January 4 and 5 emails, these Contracts would split the proceeds from each ebook sale between the publisher and Apple, with the publisher receiving 70%, and would set price caps on ebooks at $14.99, $12.99, and $9.99 depending on the book's hardcover price. But unlike the initial emails, the Contracts contained MFN Clauses in place of the requirement that publishers move all other retailers to an agency model. Apple then assured each member of the Big Six that it was being offered the same terms as the others.

The Big Six understood the economic incentives that the MFN Clause created. Suppose a new hardcover release sells at a list price of $25, and a wholesale price of $12.50. With Amazon, the publishers had been receiving the wholesale price (or a slightly lower digital wholesale price) for every ebook copy of the volume sold on Kindle, even if Amazon ultimately sold the ebook for less than that wholesale price. Under Apple's initial agency model—with price caps but no MFN Clause—the publishers already stood to make less money per ebook with Apple. Because Apple capped the ebook price of a $25 hardcover at $12.99 and took 30% of that price, publishers could only expect to make $8.75 per sale. But what the publishers sacrificed in short-term revenue, they hoped to gain in long-term stability by acquiring more control over pricing and, accordingly, the ability to protect their hardcover sales.

The MFN Clause changed the situation by making it imperative, not merely desirable, that the publishers wrest control over pricing from ebook retailers generally. Under the MFN, if Amazon stayed at a wholesale model and continued to sell ebooks at $9.99, the publishers would be forced to sell in the iBookstore, too, at that same $9.99 price point. The result would be the worst of both worlds: lower short-term revenue and no control over pricing. The publishers recognized that, as a practical matter, this meant that the MFN Clause would force them to move Amazon to an agency relationship. . . .

Apple understood this dynamic as well. As the district court found, "Apple did not change its thinking" when it replaced the explicit requirement that the publishers move other retailers to an agency model with the MFN. Indeed, in the following weeks, Apple assiduously worked to make sure that the shift to agency occurred. But Apple also understood that, as Cue bluntly put it, "any decent MFN forces the model" away from wholesale and to agency. . . .

Thus, the terms of the negotiation between Apple and the publishers became clear: Apple wanted quick and successful entry into the ebook market and to eliminate retail price competition with Amazon. In exchange, it offered the publishers an opportunity "to confront Amazon as one of an organized group ... united in an effort to eradicate the $9.99 price point." Both sides needed a critical mass of publishers to achieve their goals. The MFN played a pivotal role in this quid pro quo by "stiffen[ing] the spines of the [publishers] to ensure that they would demand new terms from Amazon," and protecting Apple from retail price competition.

4. Final Negotiations

The proposed Contracts sparked intense negotiations as Cue's team raced to assemble enough publishers to announce the iBookstore by January 27. The publishers' first volley was to push back on Apple's price caps, which they recognized would become the "standard across the industry" for pricing. In a set of meetings between January 13 and 14, the majority of the Big Six expressed a general willingness to adopt an agency model, but refused to do so with the price limits Apple demanded. Cue responded by asking Jobs for permission to create a more lenient price cap system. Under this new regime, *New York Times* bestsellers could sell for $14.99 if the hardcover was listed above $30, and for $12.99 if listed below that price. As for new releases, a $12.99 cap would apply to hardcovers priced between $25 and $27.50; a $14.99 cap would apply to hardcovers selling for up to $30; and, if the hardcover sold for over $30, publishers could sell the ebook for between $16.99 and $19.99. Jobs responded that he could "live with" the pricing "as long as [the publishers] move Amazon to the agen[cy] model too."

[The negotiations between Apple and the Big Six continued into the third and fourth week of January]. By January 22, two publishers—Simon & Schuster and Hachette—had verbally committed to join the iBookstore, while a third, Penguin, had agreed to Apple's terms in principle. As for the others, Cue was frustrated that they kept "chickening out" because of the "dramatic business change" that Apple was proposing. To make matters worse, "[p]ress reports on January 18 and 19 alerted the publishing world and Amazon to the Publishers' negotiations with Apple," and Amazon learned from Random House that it was facing "pressure from other publishers ... to move to [the] agency model because Apple had made it clear that unless all of the Big Six participated, they wouldn't bother with building a bookstore." . . .

As the district court found, during the period in January during which Apple concluded its agreements with the Publisher Defendants, "Apple kept the Publisher Defendants apprised about who was in and how many were on board." The Publisher Defendants also kept in close communication. As the district court noted, "[i]n the critical negotiation period, over the three days between January 19 and 21, [the CEOs of HarperCollins, Simon & Schuster, Penguin, Hachette, and MacMillan] called one another 34 times, with 27 calls exchanged on January 21 alone."

By the January 27 iPad launch, five of the Big Six—Hachette, HarperCollins, Macmillan, Penguin, and Simon & Schuster—had agreed to participate in the iBookstore. The lone holdout, Random House, did not join because its executives believed it would fare better under a wholesale pricing model and were unwilling to make a complete switch to agency pricing.

Steve Jobs announced the iBookstore as part of his presentation introducing the iPad. When asked after the presentation why someone should purchase an ebook from Apple for $14.99 as opposed to $9.99 with Amazon or Barnes & Noble, Jobs confidently replied, "[t]hat won't be the case ... the price will be the same.... [P]ublishers will actually withhold their [e]books from Amazon ... because they are not happy with the price." A day later, Jobs told his biographer the publishers' position with Amazon: "[y]ou're going to sign an agency contract or we're not going to give you the books."

E. Negotiations with Amazon

Jobs's boast proved to be prophetic. While the Publisher Defendants were signing Apple's Contracts, they were also informing Amazon that they planned on changing the terms of their agreements with it to an agency model. However, their move against Amazon began in earnest on January 28, the day after the iPad launch. . . .

The district court found that while Amazon was "opposed to adoption of the agency model and did not want to cede pricing authority to the Publishers," [because] it knew that it could not prevail in this position against five of the Big Six. [But, ultimately, Amazon negotiated agency agreements with the Publisher Defendants]. . . . Each of the Publisher Defendants then informed Amazon that they were under tight deadlines to negotiate new agency agreements, and kept one another informed about the details of their negotiations. As David Naggar, one of Amazon's negotiators, testified, whenever Amazon "would make a concession on an important deal point," it would "come back to us from another publisher asking for the same thing or proposing similar language." . . .

Once again, Apple closely monitored the negotiations with Amazon. The Publisher Defendants would inform Cue when they had completed agency agreements, and his team monitored price changes on the Kindle. . . .

F. Effect on Ebook Prices

As Apple and the Publisher Defendants expected, the iBookstore price caps quickly became the benchmark for ebook versions of new releases and *New York Times* bestsellers. In the five months following the launch of the iBookstore, . . . [p]rices for *New York Times* bestsellers took a . . . leap as publishers began to sell 96.8% of their bestsellers on Kindle and 99.4% of their bestsellers on the iBookstore at, or just below, the Apple price caps. During that same time period, Random House, which had not switched to an agency model, saw virtually no change in the prices for its new releases or New York Times bestsellers.

The Apple price caps also had a ripple effect on the rest of the Publisher Defendants' catalogues. Recognizing that Apple's price caps were tied to the price of hardcover books, many of these publishers increased the prices of their newly released hardcover books to shift the ebook version into a higher price category.

Furthermore, because the Publisher Defendants who switched to the agency model expected to make less money per sale than under the wholesale model, they also increased the prices on their ebooks that were not new releases or bestsellers to make up for the expected loss of revenue. . . . Increasing prices reduced demand for the Publisher Defendants' ebooks. . . .

Significantly, these changes took place against the backdrop of a rapidly changing ebook market. Amazon introduced the Kindle in November 2007, just over two years before Apple launched the iPad in January 2010. During that short period, Apple estimated that the market grew from $70 million in ebook sales in 2007 to $280 million in 2009, and the company projected those figures to grow significantly in following years. . . .

II. PROCEDURAL HISTORY

On April 11, 2012, Plaintiffs filed a pair of civil antitrust actions in the United States District Court for the Southern District of New York. The complaints alleged that Apple and the Publisher Defendants—Hachette, HarperCollins, Macmillan, Penguin, and Simon & Schuster—conspired to raise, fix, and stabilize the retail price for newly released and bestselling trade ebooks in violation of § 1 of the Sherman Act. . . .

A. Publisher Defendants

Hachette, HarperCollins, and Simon & Schuster agreed to settle with DOJ by signing consent decrees on the same day that the Justice Department filed its complaint. . . . The remaining Publisher Defendants, Penguin and Macmillan, settled in quick succession. . . .

B. Apple

Unlike the Publisher Defendants, Apple opted to take the case to trial. . . . On July 10, 2013, after conducting a three-week bench trial, the district court concluded that Apple had violated § 1 of the Sherman Act. In brief, the court found that Apple "orchestrat[ed]" a conspiracy among the Publisher Defendants to "eliminate retail price competition [in the e-book market] in order to raise the retail prices of e-books." . . .

DISCUSSION

To hold a defendant liable for violating § 1 of the Sherman Act, a district court must find a combination or some form of concerted action between at least two legally distinct economic entities that constituted an unreasonable restraint of trade. . . .

I. STANDARD OF REVIEW

Following a bench trial, this Court reviews the district court's findings of fact for clear error and its conclusions of law and mixed questions *de novo*. . . .

II. APPLE'S LIABILITY UNDER § 1

This appeal requires us to address the important distinction between "horizontal" agreements to set prices, which involve coordination between competitors at the same level of a market structure, and "vertical" agreements on pricing, which are created between parties at different levels of a market structure. Under § 1 of the Sherman Act, the former are, with limited exceptions, *per se* unlawful, while the latter are unlawful only if an assessment of market effects, known as a rule-of-reason analysis, reveals that they unreasonably restrain trade. See *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 551 U.S. 877, 893 (2007).

Although this distinction is sharp in theory, determining the orientation of an agreement can be difficult as a matter of fact and turns on more than simply identifying whether the participants are at the same level of the market structure. For instance, courts have long recognized the existence of "hub-and-spoke" conspiracies in which an entity at one level of the market structure, the "hub," coordinates an agreement among competitors at a different level, the "spokes." *Howard Hess Dental Labs. Inc. v. Dentsply Int'l, Inc.*, 602 F.3d 237, 255 (3d Cir. 2010); see also *Toys "R" Us, Inc. v. FTC*, 221 F.3d 928, 932–34 (7th Cir. 2000). These arrangements consist of both vertical agreements between the hub and each spoke and a horizontal agreement among the spokes to adhere to the hub's terms, often because the spokes would not have gone along with the vertical agreements except on the understanding that the other spokes were agreeing to the same thing. . . .

Apple characterizes its Contracts with the Publisher Defendants as a series of parallel but independent vertical agreements, a characterization that forms the basis for its two primary arguments against the district court's decision.

First, Apple argues that the district court impermissibly inferred its involvement in a horizontal price-fixing conspiracy from the Contracts themselves. Because (in Apple's view) the Contracts were vertical, lawful, and in Apple's independent economic interest, the mere fact that Apple agreed to the same terms with multiple publishers cannot establish that Apple consciously organized a conspiracy among the Publisher Defendants to raise consumer-facing ebook prices—even if the *effect* of its Contracts was to raise those prices.

Second, Apple argues that, even if it did orchestrate a horizontal price-fixing conspiracy, its conduct should not be subject to *per se* condemnation. According to Apple, proper application of the rule of reason reveals that its conduct was not unlawful.

For the reasons set forth below, we reject these arguments. . . .

A. The Conspiracy With the Publisher Defendants

. . . Identifying the existence and nature of a conspiracy requires determining whether the evidence "reasonably tends to prove that the [defendant] and others had a conscious commitment to a common scheme designed to achieve an unlawful objective." *Monsanto Co. v. Spray–Rite Serv. Corp.*, 465 U.S. 752, 764 (1984).

Parallel action is not, by itself, sufficient to prove the existence of a conspiracy; such behavior could be the result of "coincidence, independent responses to common stimuli, or mere interdependence unaided by an advance understanding among the parties." Indeed, parallel behavior that does not result from an agreement is not unlawful even if it is anticompetitive. See *In re Text Messaging Antitrust Litig.*, 782 F.3d 867, 873–79 (7th Cir. 2015); *In re Flat Glass Antitrust Litig.*, 385 F.3d 350, 360–61 (3d Cir. 2004). Accordingly, to prove an antitrust conspiracy, "a plaintiff must show the existence of additional circumstances, often referred to as 'plus' factors, which, when viewed in conjunction with the parallel acts, can serve to allow a fact-finder to infer a conspiracy."

These additional circumstances can, of course, consist of direct evidence that the defendants entered into an agreement like a recorded phone call in which two competitors agreed to fix prices. *Mayor & City Council of Baltimore, Md. v. Citigroup, Inc.*, 709 F.3d 129, 136 (2d Cir. 2013). But plaintiffs may also "present circumstantial facts supporting the inference that a conspiracy existed." *Id.* Circumstances that may raise an inference of conspiracy include "a common motive to conspire, evidence that shows that the parallel acts were against the apparent individual economic self-interest of the alleged conspirators, and evidence of a high level of interfirm communications." *Id.* Parallel conduct alone may support an inference of conspiracy, moreover, if it consists of "complex and historically unprecedented changes in pricing structure made at the very same time by multiple competitors, and made for no other discernible reason." *Id.*

Because of the risk of condemning parallel conduct that results from independent action and not from an actual unlawful agreement, the Supreme Court has cautioned against drawing an inference of conspiracy from evidence that is equally consistent with independent conduct as with illegal conspiracy—or, as the Court has called it, "ambiguous" evidence. *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 597 n. 21 (1986). Thus, a finding of conspiracy requires evidence that tends to exclude the possibility that the defendant was acting independently.

This requirement, however, does not mean that the plaintiff must disprove all non-conspiratorial explanations for the defendants' conduct; rather, the evidence need only be sufficient to allow a reasonable fact finder to infer that the conspiratorial explanation is more likely than not.

Apple portrays its Contracts with the Publisher Defendants as, at worst, "unwittingly facilitating" their joint conduct. All Apple did, it claims, was attempt to enter the market on profitable terms by offering contractual provisions—an agency model, the MFN Clause, and tiered price caps—which ensured the company a small profit on each ebook sale and insulated it from retail price competition. This had the effect of raising prices because it created an incentive for the Publisher Defendants to demand that Amazon adopt an agency model and to seize control over consumer-facing ebook prices industry-wide. . . . Apple's success in capitalizing on the Publisher Defendants' preexisting incentives, it contends, does not suggest that it joined a conspiracy among the Publisher Defendants to raise prices. In sum, Apple's basic argument is that because its Contracts with the Publisher Defendants were fully consistent with its independent business interests, those agreements provide only "ambiguous" evidence of a § 1 conspiracy, and the district court therefore erred under *Matsushita* and *Monsanto* in inferring such a conspiracy.

We disagree. At the start, Apple's benign portrayal of its Contracts with the Publisher Defendants is not persuasive—not because those Contracts themselves were independently unlawful, but because, in context, they provide strong evidence that

Apple consciously orchestrated a conspiracy among the Publisher Defendants. . . . In addition to these Contracts, moreover, ample additional evidence identified by the district court established both that the Publisher Defendants' shifting to an agency model with Amazon was the result of express collusion among them and that Apple consciously played a key role in organizing that collusion. . . .

Apple offered each Big Six publisher a proposed Contract that would be attractive only if the publishers acted collectively. Under Apple's proposed agency model, the publishers stood to make less money per sale than under their wholesale agreements with Amazon, but the Publisher Defendants were willing to stomach this loss because the model allowed them to sell new releases and bestsellers for more than $9.99. . . . By the very act of signing a Contract with Apple containing an MFN Clause, then, each of the Publisher Defendants signaled a clear commitment to move against Amazon, thereby facilitating their collective action. . . .

The Supreme Court has defined an agreement for Sherman Act § 1 purposes as "a conscious commitment to a common scheme designed to achieve an unlawful objective." *Monsanto Co. v. Spray-Rite Service Corp.*, 465 U.S. 752, 764 (1984). Plainly, this use of the promise of higher prices as a bargaining chip to induce the Publisher Defendants to participate in the iBookstore constituted a conscious commitment to the goal of raising ebook prices. Antitrust law has never required identical motives among conspirators when their independent reasons for joining together lead to collusive action. . . .

Nor was the Publisher Defendants' joint action against Amazon a result of parallel decisionmaking. As we have explained, conduct resulting solely from competitors' independent business decisions—and not from any "agreement"—is not unlawful under § 1 of the Sherman Act, even if it is anticompetitive. . . . That the Publisher Defendants were in constant communication regarding their negotiations with both Apple and Amazon can hardly be disputed. Indeed, Apple never seriously argues that the Publisher Defendants were not acting in concert. . . .

Given the record and the district court's factual findings, we do not share Apple and its amici's concern that we will stifle productive enterprise by inferring an agreement among Apple and the Publisher Defendants on the basis of otherwise lawful contract terms, such as an agency model and MFNs.

To begin with, it is well established that vertical agreements, lawful in the abstract, can in context be useful evidence for a plaintiff attempting to prove the existence of a horizontal cartel, particularly where multiple competitors sign vertical agreements that would be against their own interests were they acting independently, *see, e.g.*, *Interstate Circuit v. United States*, 306 U.S. 208, 222 (1939); also *Toys "R" Us, Inc. v. FTC*, 221 F.3d 928, 935–36 (7th Cir. 2000). The MFNs in Apple's Contracts created a set of economic incentives pursuant to which the Contracts were only attractive to the Publisher Defendants to the extent they acted collectively. . . .

Having concluded that the district court correctly identified an agreement between Apple and the Publisher Defendants to raise consumer-facing ebook prices, we turn to Apple's and the dissent's arguments that this agreement did not violate § 1 of the Sherman Act.

B. Unreasonable Restraint of Trade

The Supreme Court has long recognized that Congress intended to outlaw only unreasonable restraints. . . .

[In antitrust cases], *per se* and rule-of-reason analysis are two methods of determining whether a restraint is 'unreasonable,' *i.e.*, whether its anticompetitive effects outweigh its procompetitive effects. Because this balancing typically requires case-by-case analysis, most antitrust claims are analyzed under the 'rule of reason,' according to which the finder of fact must decide whether the questioned practice imposes an unreasonable restraint on competition. However, some restraints have such predictable and pernicious anticompetitive effect, and such limited potential for procompetitive benefit, that they are deemed unlawful per se.

Horizontal price-fixing conspiracies traditionally have been, and remain, the "archetypal example" of a per se unlawful restraint on trade. *Catalano, Inc. v. Target Sales, Inc.*, 446 U.S. 643, 647 (1980). By contrast, the Supreme Court in recent years has clarified that vertical restraints—including those that restrict prices—should generally be subject to the rule of reason. . . .

In this case, the district court held that the agreement between Apple and the Publisher Defendants was unlawful under the *per se* rule; in the alternative, even assuming that a rule-of-reason analysis was required, the district court concluded that the agreement was still unlawful. . . .

1. Whether the Per Se Rule Applies

a. Horizontal Agreement

. . . "The true test of legality" under § 1 of the Sherman Act "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." *Bd. of Trade of City of Chi. v. United States*, 246 U.S. 231, 238 (1918) By agreeing to orchestrate a horizontal price-fixing conspiracy, Apple committed itself to achieving that unlawful objective: namely, collusion with and among the Publisher Defendants to set ebook prices. This type of agreement, moreover, is a restraint that would always or almost always tend to restrict competition and decrease output.

The response, raised by Apple and our dissenting colleague, that Apple engaged in "vertical conduct" that is unfit for *per se* condemnation therefore misconstrues the Sherman Act analysis. . . . [T]he Supreme Court and our Sister Circuits have held all participants in "hub-and-spoke" conspiracies liable when the objective of the conspiracy was a per se unreasonable restraint of trade. . . . A horizontal conspiracy can use vertical agreements to facilitate coordination without the other parties to those agreements knowing about, or agreeing to, the horizontal conspiracy's goals.

In short, the relevant "agreement in restraint of trade" in this case is the price-fixing conspiracy identified by the district court, not Apple's vertical contracts with the Publisher Defendants. . . .

b. "Enterprise and Productivity"

Apple seeks refuge from the *per se* rule by invoking a line of cases in which courts have permitted defendants to introduce procompetitive justifications for horizontal price-fixing arrangements that would ordinarily be condemned *per se* if those agreements when adopted could reasonably have been believed to promote 'enterprise and productivity.' The decisions falling in this line are narrow, and they do not support Apple's position.

In *Broadcast Music, Inc. v. Columbia Broadcasting System, Inc.* ("*BMI*"), the defendants were corporations formed by copyright owners to negotiate "blanket licenses" allowing licensees to perform any of the licensed works for a flat fee. 441 U.S. 1, 4–6 (1979). Although this scheme literally amounted to "price fixing" by the defendants' members, the Court upheld it under the rule of reason because blanket licenses were the only way to eliminate the "prohibitive" cost of each copyright owner's individually negotiating licenses, monitoring licensees' use of their work, and enforcing the licenses' terms.

In *National Collegiate Athletic Ass'n v. Board of Regents of the University of Oklahoma* ("*NCAA*"), the Court relied on BMI in applying the rule of reason to (but ultimately striking down) restrictions placed by the NCAA on the number of football games that its members could agree with television networks to broadcast. . . .

The Supreme Court has characterized these decisions as limited to situations where the "restraints on competition are essential if the product is to be available at all." *Am. Needle, Inc. v. Nat'l Football League*, 560 U.S. 183, 203 (2010). But even if read broadly, these cases, and others in this category, apply the rule of reason only when the restraint at issue was imposed in connection with some kind of potentially efficient joint venture. . . . Here, there was no joint venture or other similar productive relationship between any of the participants in the conspiracy that Apple joined. Apple also does not claim, nor could it, that creating an ebook retail market is possible only if the participating publishers coordinate with one another on price.

c. Price–Fixing Conspiracy

As noted, the Supreme Court has for nearly 100 years held that horizontal collusion to raise prices is the "archetypal example" of a *per se* unlawful restraint of trade. If successful, these conspiracies concentrate the power to set prices among the conspirators, including the "power to control the market and to fix arbitrary and unreasonable prices." *United States v. Trenton Potteries Co.*, 273 U.S. 392, 397 (1927). And even if unsuccessful or "not ... aimed at complete elimination of price competition," the conspiracies pose a "threat to the central nervous system of the economy" by creating a dangerously attractive opportunity for competitors to enhance their power at the expense of others. *United States v. Socony–Vacuum Oil Co.*, 310 U.S. 150, 224 n. 59 (1940). . . .

. . . The conspiracy among Apple and the Publisher Defendants comfortably qualifies as a horizontal price-fixing conspiracy. . . . [T]he Publisher Defendants took by collusion what they could not win by competition. And Apple used the publishers' frustration with Amazon's $9.99 pricing as a bargaining chip in its negotiations and structured its Contracts to coordinate their push to raise prices throughout the industry. A coordinated effort to raise prices across the relevant market was present in every chapter of this story. . . .

2. Rule of Reason

[N]either Apple nor the dissent has presented any particularly strong reason to think that the conspiracy we have identified should be spared *per se* condemnation. . . . Nonetheless, I am mindful of Apple's argument that the nascent ebook industry has some new and unusual features and that the *per se* rule is not fit for business relationships where the economic impact of certain practices is not immediately obvious. . . . I therefore assume, for the sake of argument, that it is appropriate to apply the rule of reason and to analyze the competitive effects of Apple's horizontal agreement with the Publisher Defendants.

Notably, however, the ample evidence here concerning the purpose and effects of Apple's agreement with the Publisher Defendants affects the scope of the rule-of-reason analysis called for in this case. Under a prototypically robust rule-of-reason analysis, the plaintiff must demonstrate an "actual adverse effect" on competition in the relevant market before the "burden shifts to the defendants to offer evidence of the pro-competitive effects of their agreement." . . . But not every case that requires rule of reason analysis is a candidate for plenary market examination. What is required, rather, is an enquiry meet for the case, looking to the circumstances, details, and logic of a restraint.

To that end, the Supreme Court has applied an abbreviated version of the rule of reason—otherwise known as "quick look" review—to agreements whose anticompetitive effects are easily ascertained. This "quick look" effectively relieves the plaintiff of its burden of providing a robust market analysis, by shifting the inquiry directly to a consideration of the defendant's procompetitive justifications. . . . Here, the same evidence supporting our determination that *per se* condemnation is the correct way to dispose of this appeal also supports at most a "quick look" inquiry under the rule of reason. . . . A quick-look approach operates only to shift the rule-of-reason analysis directly to Apple's procompetitive justifications for organizing the conspiracy. . . .

CONCLUSION

We have considered the appellants' remaining arguments and find them to be without merit. Because we conclude that Apple violated § 1 of the Sherman Act by orchestrating a horizontal conspiracy among the Publisher Defendants to raise ebook prices, and that the injunctive relief ordered by the district court is appropriately designed to guard against future anticompetitive conduct, the judgment of the district court is **AFFIRMED**.

LOHIER, Circuit Judge, concurring in part and concurring in the judgment:

I join in the majority opinion except for part II.B.2 relating to the application of the rule of reason. In my view, Apple's appeal rises or falls based on the application of the *per se* rule. . . . I would affirm on that basis alone. . . .

DENNIS JACOBS, Circuit Judge, dissenting:

I respectfully dissent.

. . . I have no quarrel with the district court's conscientious findings of fact. . . . All that is needed to decide the case, however, are the schematic facts that show the architecture of the horizontal and vertical arrangements and the dynamics of the competitive forces. . . .