13-3741(L)

13-3748(CON), 13-3783(CON), 13-3857(CON), 13-3864(CON), 13-3867(CON)

United States Court of Appeals
for the Second Circuit

UNITED STATES OF AMERICA, STATE OF TEXAS, STATE OF CONNECTICUT, STATE OF ALABAMA, STATE OF ALASKA, STATE OF ARIZONA, STATE OF ARKANSAS, STATE OF COLORADO, STATE OF DELAWARE, STATE OF IDAHO, STATE OF ILLINOIS, STATE OF INDIANA, STATE OF IOWA, STATE OF KANSAS, STATE OF LOUISIANA,

(*Additional caption on inside cover*)

On Appeal from the United States District Court
for the Southern District of New York
No. 12-cv-2826 (DLC)

APPELLANT APPLE INC.'S OPENING BRIEF

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(*Caption continued*)

STATE OF MARYLAND, COMMONWEALTH OF MASSACHUSETTS, STATE OF MICHIGAN, STATE OF MISSOURI, STATE OF NEBRASKA STATE OF NEW MEXICO, STATE OF NEW YORK, STATE OF NORTH DAKOTA, STATE OF OHIO, COMMONWEALTH OF PENNSYLVANIA, STATE OF SOUTH DAKOTA, STATE OF TENNESSEE, STATE OF UTAH, STATE OF VERMONT, COMMONWEALTH OF VIRGINIA, STATE OF WEST VIRGINIA, STATE OF WISCONSIN, COMMONWEALTH OF PUERTO RICO, AND DISTRICT OF COLUMBIA,

Plaintiffs - Appellees,

v.

APPLE, INC., SIMON & SCHUSTER, INC., VERLAGSGRUPPE GEORG VON HOLTZBRINCK GMBH, HOLTZBRINCK PUBLISHERS, LLC, DBA MACMILLAN, SIMON & SCHUSTER DIGITAL SALES, INC.,

Defendants - Appellants,

HACHETTE BOOK GROUP, INC., HARPERCOLLINS PUBLISHERS L.L.C., THE PENGUIN GROUP, A DIVISION OF PEARSON PLC, PENGUIN GROUP (USA), INC.,

Defendants.

CORPORATE DISCLOSURE STATEMENT

Pursuant to Rule 26.1 of the Federal Rules of Appellate Procedure, defendant-appellant Apple Inc. states that it has no parent corporation. To the best of Apple's knowledge and belief, and based on publicly filed disclosures, as of July 15, 2014, no publicly held corporation owns 10% or more of Apple's stock.

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INTRODUCTION

The district court's ruling that Apple, in the very act of launching the iPad, inventing the iBooks Store, and entering the e-books market, violated the Sherman Act is a radical departure from modern antitrust law and policy. If allowed to stand, the ruling will stifle innovation, chill competition, and harm consumers. This Court should overturn it.

Apple's entry as an e-book retailer marked the *beginning*, not the end, of competition. In 2010, Apple launched and expanded a viable bookstore with thousands of e-book publishers, including the five publisher defendants in this action, on the strength of agency agreements that the district court recognized were themselves perfectly lawful. Instead of a market dominated by a single retailer—Amazon—controlling 9 out of every 10 e-book sales, a competitive market emerged where output exploded and average price dropped. Although some publishers used their agency authority to raise prices for some e-books that had been used as "loss leaders" by Amazon, the court expressly did *not* find that "Apple itself desired higher e-book prices than those offered at Amazon." A2151; A2285 n.68. The court *did* find that the iPad "encouraged innovation and competition" and that "having the creativity and commitment of Apple invested in the enhancement of a product like the iBookstore is extremely beneficial to consumers and competition." A2290 & n.69.

As shown below, the district court's ruling condemning Apple's market entry as *per se* illegal turns the antitrust laws upside down. The court repeatedly applied the wrong legal standards, which led it to jump to the false conclusion of a price-fixing conspiracy from Apple's lawful, unilateral, and procompetitive business activities. This Court should reverse.

STATEMENT OF JURISDICTION

The district court had jurisdiction over the United States' Sherman Act claims in No. 13-3741 under 15 U.S.C. § 4 and 28 U.S.C. §§ 1331, 1345; this Court has jurisdiction over the court's final judgment under 28 U.S.C. § 1291. The district court had jurisdiction in No. 13-3857 over the plaintiff states' Sherman Act and state-law antitrust claims under 28 U.S.C. §§ 1331, 1367(a); this Court has jurisdiction over the court's permanent injunction under 28 U.S.C. § 1292(a)(1). Apple timely noticed appeals on October 3, 2013. A2572-73; A2574-75.

STATEMENT OF THE ISSUES

1. Whether the district court erred in finding that Apple's negotiation and execution of lawful agency agreements with the publisher defendants, which Apple pursued in its independent business interests, nevertheless evinced a price-fixing conspiracy in violation of the Sherman Act;

2. Whether the district court erred in finding Apple *per se* liable, or alternatively liable under the rule of reason, for price-fixing;

3. Whether the district court erred in excluding unrebutted expert evidence of the procompetitive effects of Apple's conduct; and

4. Whether the injunction, including the monitorship provision, exceeds the court's authority and violates the separation of powers.

STATEMENT OF THE CASE

The Department of Justice brought this civil action against Apple and five e-book publishers, alleging that they conspired to fix e-book prices in December 2009 and January 2010. A895. Thirty-three states and territories sued under Section 4C of the Clayton Act and state antitrust laws. A953. The district court (Cote, J.) scheduled a trial on injunctive relief in both cases, with a trial of damage claims in the states' action to follow if needed. A1042-45. The publishers entered into consent decrees. A1117; A1824; A2388. Apple proceeded to trial. After a three-week bench trial in June 2013, the district court on July 10, 2013, found that Apple violated section 1 and congruent state statutes. A2135; *United States v. Apple Inc.*, 952 F. Supp.2d 638 (S.D.N.Y. 2013). On September 5, 2013, the court entered its final judgment in the DOJ case and ordered injunctions in both actions. A2555; *see United States v. Apple, Inc.*, 2013 WL 4774755 (S.D.N.Y. Sept. 5, 2013). Apple timely appealed. A2572-73; A2574-75.

STATEMENT OF FACTS

I. Apple's Entry into the E-Books Market

E-books are "books that are sold to consumers in electronic form" and are most commonly read on an "e-reader" device. A2147-48. "Trade" e-books (the relevant market here (A2255 n.60)) are sold to the general public, unlike, for example, textbooks or technical manuals. A2147 n.4. In 2009, there were six major trade e-book publishers—five of which (Hachette, HarperCollins, Macmillan, Penguin, and Simon & Schuster) were defendants in this action; the largest publisher (Random House) was not. A2147 n.5.

Through 2009, the publisher defendants sold e-books to Amazon and other retailers on a "wholesale model," under which the retailer sets the consumer price for an e-book title while paying the publisher usually 50% of the book's list price. A2148; A2187. Amazon set virtually every retail price in the trade e-book market, "selling nearly 90% of all e-books." A2148.

Amazon was using e-book versions of many hardcover new releases and *New York Times* bestsellers as "loss leaders." A2167; A266; A1680¶6; A1692-93¶5; A1704-05¶9; A1721-22¶7; A1887-88¶10; A1900¶51. Before April 2010, over 80% of Amazon's *New York Times* bestseller sales and 60% of its hardcover new release sales were priced at $9.99 (A1900¶51), which was often several dollars below the e-book's wholesale price (A2148; A2151).

Publishers separately—and very publicly—voiced concerns with Amazon's e-book pricing strategy. A2156-58. In September 2009, some publishers began delaying some e-book versions of new releases, a practice known as "windowing." A2154-59. The publishers' pricing complaints and windowing tactics were widely reported in the press in 2009, including in *The Wall Street Journal* and *The New York Times* in December. A2156-58. These reports made clear that publishers were concerned that Amazon's loss-leader pricing was threatening authors, brick and mortar retailers, and the publishing industry itself by "cannibalizing new best-selling hardcovers, which are the mainstay of the publishing business." A2156-57.

In late 2009, Apple was preparing to launch the iPad, "a revolutionary device that has encouraged innovation and competition" in the e-book market. A2290. The iPad would be a "great device for reading e-books," and Apple decided to create the iBooks Store, which would allow Apple to sell e-books to iPad users and would debut concurrently with the iPad launch in early 2010. A2161-63. Apple had almost no experience or contacts in the book industry. A1976.265:3-5; A1763¶23.

On December 15 and 16, 2009, Apple held an introductory round of individual meetings with each of the six major publishers in New York. A2164. These meetings were preliminary brainstorming sessions (*e.g.*, A1767-68¶¶38-40; A1708-09¶22; A1683-85¶¶19-24; A1729¶23; A1976.264:21-265:2; A1993.490:7-

9; A2000.549:6-550:3), and the parties "did not reach any agreements" (A1775¶62; A1683-86¶¶19-27; A367; A1695-96¶¶13-16; A1708-09¶22; A1976.266:2-6; A1984.400:22-25; A2027.1186:12-15; A2037.1448:8-17; A2278). But Apple did indicate it was unwilling to price below cost and that it "was willing to sell e-books at prices up to $14.99." A2166; A2279; *see* A1768-69¶¶41-42; A1684¶22; A1729¶23; A336-39.

Apple initially contemplated adopting the same wholesale model that Amazon was using (A1767¶36), but at the suggestion of some publishers (A2168), following these meetings, Apple proposed "an agency model," which would allow each publisher to set its own prices and provide Apple "with a 30% commission, the same commission it was using in its App Store" (A2173). Apple's original proposal suggested that a publisher implement agency with all of its distributors (A2176; A2179-80), but Apple realized almost immediately that this was unnecessary and excluded the term from the draft contracts it circulated on January 11, 2010 (A2181-85).

The agreements lasted only one year, prohibited "windowing," capped prices for new releases and *New York Times* bestsellers, and contained Most Favored Nation ("MFN") clauses (A2185), which "guaranteed that the e-books in Apple's e-bookstore would be sold for the lowest retail price available in the marketplace" (A2181). Apple resolved to open the iBooks Store only on these terms and with a

critical mass of publishers in order to have a viable business. A1758¶10; A1773¶56; A1785-86¶95; A1695¶15; A1709¶23; A1741-42¶16; A1684¶21; A2165; A2167; A2181.

Two weeks of "intensive negotiations" ensued. A2186. Apple never met or spoke with more than one publisher at a time. A2280-81; A1785¶92; A1714¶¶39-40; A1734¶36. By January 26, Apple had signed five of the six major publishers. A2200. Apple subsequently signed significant independent publishers (*e.g.*, Hyperion, Perseus) to its agency model with the same basic terms, and put a "click-through" agency agreement online that ultimately attracted thousands of independent publishers and self-publishers to the exact same model. A1789-90¶¶106-08; A1752-53¶45. These agreements allowed Apple to open a bookstore in which all these publishers could sell books at any price they wished, subject to the price caps and MFNs.

On January 27, 2010, Apple's founder, Steve Jobs, unveiled the iPad and its e-reader capability and announced the iBooks Store. A2219. Mr. Jobs demonstrated the ease of buying an e-book by browsing through the iBooks "bookshelf," clicking on the "store" button, watching the shelf flip to the iBooks Store, and "purchas[ing]" the late Edward M. Kennedy's memoir, *True Compass*, published by Hachette. A2219.

By the end of March 2010, Amazon had entered into agency agreements with Macmillan, HarperCollins, Hachette, and Simon & Schuster. A2226. Penguin signed with Amazon on June 2, 2010. A2227. Barnes & Noble, which had been discussing an agency model with the publishers in 2009 (A2168; A1818¶¶17-18), negotiated and signed agency agreements including MFNs with the publisher defendants between January and April 2010 (A702; A720; A738; A777; A800; *see* A1819-20¶¶21-22; A1820¶28).[1]

Once the iBooks Store opened in April 2010, the e-book retailer market diversified substantially. While in 2009 Amazon sold nearly 90% of all e-books (A2148), by 2011, Apple and Barnes & Noble together accounted for between 30% and 40% of e-book sales (SEA44).

The trade e-book market in the United States saw a substantial increase in e-book sales. SEA44. Self-published e-book sales in particular were stimulated by Apple's model (which Amazon immediately emulated), as self-publishers jumped at retaining 70% of an e-book's price, twice the amount Amazon previously offered. A1752-53¶45; A1897¶¶40-42; SEA45; A2150 n.8.

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[1] The court declared that "[t]here is simply no credible evidence that Amazon moved willingly to the agency model in 2010" (A2202 n.36), but the court barred critical discovery from Amazon on this and many other issues (2/26/13 Hr'g Tr.5:11-17:9).

Apple's entry on agency stimulated competition in the trade e-books market as a whole, which drove average prices *downward* (A1885¶4; A2042.1506:19-1507:1), soon reaching levels never seen under Amazon's hegemony (A2763; A1176). The great bulk—more than 75%—of the e-books offered by Apple and Amazon were priced at $9.99 or less. A1887¶8; A870-71 (510,000 of Amazon's 630,000 e-books, including 75 bestsellers, priced at $9.99 or less).

While the publisher defendants raised prices on many new release e-book titles (A2228-29), as did Random House when it independently set its agency prices in 2011 (A1176), the price changes were not uniform; prices were affected "to varying degrees" (A1893¶27; A1179; A1908-09¶10; A1914-15¶26; A2041.1493:23-1494:4). Prices of more than half of the publisher defendants' new release and bestseller titles sold at Amazon, Barnes & Noble, and Sony remained unchanged or decreased after the Apple agency agreements went into effect. A1886¶6; A1893¶28; A1180; A1182; A1183. For instance, the price of *True Compass*—the book Mr. Jobs highlighted at the iPad announcement—fell from $19.25 (Amazon's selling price in March 2010) to the capped price of $16.99 after the iBooks Store opened. A2116.2299:5-24.

The iPad—which the court termed a "revolutionary tablet" (A2161)—also sparked innovation and competition in e-reading hardware and software and digital

publishing (A2162-63; A2290; A1526¶¶7-8; A1535-44¶¶30-40; A2125.2380:2-A2126.2382:20).

II. Trial and Post-Trial Proceedings

The publisher defendants entered into consent decrees with plaintiffs. A1072; A1823; A1824. Apple's trial was almost a year away, but in September 2012, in the face of "voluminous and overwhelmingly negative" public comments (A1090)—including criticism "that prices for many e-books actually went down under the agency model" (A1079 n.4)—the district court adjudged that the first three decrees "appear[] reasonably calculated to *restore* retail price competition to the market for trade e-books [and] to *return* prices to their competitive level." A1087 (emphasis added).

Then, in the final conference before trial, and without having reviewed all the direct testimony or heard from a single witness (A1849.48:9-12; A1850.49:1-3), and after excluding critical expert evidence, the district court announced that it "believe[d] that the government [would] 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 … [would] confirm that." A1850.49:3-8.

On July 10, 2013, three weeks after trial concluded, the court issued its 160-page ruling. The court acknowledged that "*[l]awful* distribution arrangements

between suppliers and distributors certainly include agency arrangements," and "*entirely lawful* contracts may include an MFN, price caps, or pricing tiers." A2266 (emphases added). In short, the district court *did not* find that "the [Agency] Agreements by themselves reflect an agreement in restraint of trade." A2266-67. The court even acknowledged that the "*record is equivocal on whether Apple itself desired higher e-book prices than those offered at Amazon*." A2285 n.68 (emphasis added).[2]

But the court nonetheless found that Apple entered into a conspiracy with the publishers "at th[e] initial meetings [on December 15 and 16, 2009,] in New York City." A2278. The court found no ambiguity in the record and no reason for "hesitation before finding Apple liable" for having "participated in and facilitated a horizontal price-fixing conspiracy," which the court deemed "a *per se* violation of the Sherman Act." A2254; A2268 (citations omitted). In the alternative, the court found that "[i]f it were necessary to analyze this evidence under the rule of reason, … the Plaintiffs would also prevail." A2254-55.

On September 5, 2013, the court entered final judgment and an injunction, which, among other things, required Apple to modify its agreements with the publishers, imposed restrictions on its App Store and other activities, and imposed

[2] Sales of e-books generate a very small fraction of Apple's overall revenue. A1532-33¶22.

an "External Compliance Monitor" to review the company's antitrust compliance and training policies. A2555-71.

Based on these rulings, the plaintiff states and private class action plaintiffs seek treble damages exceeding $800 million.

SUMMARY OF ARGUMENT

I. The district court erred as a matter of law in finding Apple liable for a price-fixing conspiracy.

A. The district court's decision is based on a fundamentally incorrect theory of antitrust liability. The court, despite recognizing the lawfulness of Apple's agency agreements and negotiating tactics, found that Apple, by doing nothing more than hearing out the publishers' complaints and conveying its openness to pricing above $9.99, joined an ongoing conspiracy in its first exploratory meetings in mid-December 2009. But the Supreme Court has squarely held that section 1 does not bar vertical market players—like Apple and a publisher—from discussing pricing, or registering price complaints and concerns, recognizing the "legitimate reasons" for such "natural" and "unavoidable" discussions. *Monsanto Co. v. Spray-Rite Serv. Corp.*, 465 U.S. 752, 762-63 (1984) (internal quotation marks omitted). And the Supreme Court has squarely rejected the district court's assumption that actions that result in some price increases are *ipso facto* anti-

competitive. *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 551 U.S. 877, 886-87, 895-97 (2007).

Apple had no knowledge that the publishers were engaged in a conspiracy in December 2009 or at any other point. The district court's own findings show that Apple offered a retail business model to the publishers that was in Apple's independent business interests and was attractive to the publishers, who were frustrated with Amazon. And it was not unlawful for Apple to take advantage of retail market discord by using lawful agency agreements to enter the market and compete with Amazon.

B. The district court compounded its erroneous theory of antitrust liability by *unhesitatingly* drawing inferences of a conspiracy from unilateral conduct that was indisputably in Apple's independent business interests. The court's mode of analysis defies modern Supreme Court jurisprudence, which erects "stringent standards" (*Leegin*, 551 U.S. at 903) sharply limiting the inferences courts may draw from ambiguous evidence. The evidence from which the district court inferred a conspiracy was all, at best, highly ambiguous, and cannot support a finding of a conspiracy. *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 588 (1986); *Monsanto*, 465 U.S. at 763-64.

II. The district court's conclusion that Apple was *per se* liable under section 1 was erroneous, as was the court's one-paragraph rule-of-reason analysis.

A. The Supreme Court has established "demanding standards" that confine application of the *per se* rule to restraints that are manifestly anticompetitive and lack any redeeming virtue, but Apple's entry through vertical distribution agreements was *procompetitive*. It kick-started competition in a highly concentrated market, delivering higher output, lower price levels, and accelerated innovation. The district court therefore erred in condemning Apple's conduct as *per se* unlawful. *Leegin*, 551 U.S. at 886-87; *State Oil Co. v. Khan*, 522 U.S. 3, 17 (1997).

B. The court's one-paragraph rule-of-reason analysis was also incorrect. It impermissibly relieved plaintiffs of their burden of proving anti-competitive effects (*Capital Imaging Assocs., P.C. v. Mohawk Valley Med. Assocs., Inc.*, 996 F.2d 537, 543 (2d Cir. 1993)), and focused solely on the prices and output of the publisher defendants, ignoring the undisputed benefits to the market as a whole from Apple's entry (*Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 31 (1984)).

III. The district court improperly and prejudicially excluded critical expert evidence establishing that Apple's entry and introduction of the agency model in the market *caused* average prices to decrease overall. At the same time, the court applied a double standard, itself soliciting testimony on the same topic from plaintiffs' expert, who had not even analyzed the issue.

IV. The injunction's restrictions on Apple's business activities are improper and unnecessary. In particular, the monitor provision is unprecedented and unconstitutional. *See Cobell v. Norton*, 334 F.3d 1128 (D.C. Cir. 2003).

STANDARD OF REVIEW

A district court's determination that a defendant's conduct "constitute[s] a combination or conspiracy in violation of the Sherman Act is a matter of law, reviewed *de novo*." *Tokarz v. LOT Polish Airlines*, 258 F. App'x 377, 378 (2d Cir. 2007) (summary order) (internal quotation marks omitted). Where the "key evidence" at trial "consisted primarily of documents and expert testimony," as in this case, the factual findings are subject to "an extensive review … for clear error." *Easley v. Cromartie*, 532 U.S. 234, 243 (2001). Evidentiary rulings are reviewed for an abuse of discretion (*Cameron v. City of N.Y.*, 598 F.3d 50, 61 (2d Cir. 2010)), but a "discretionary ruling based on an error of law is necessarily an abuse of discretion" (*United States v. All Funds Distributed to, or ex rel. Weiss*, 345 F.3d 49, 54 (2d Cir. 2003)).

ARGUMENT

To prove a violation under section 1 of the Sherman Act, a plaintiff must establish a "contract, combination …, or conspiracy, in restraint of trade or commerce." 15 U.S.C. § 1. The statute does not prohibit all restraints of trade, but only "*unreasonable* restraints." *State Oil Co. v. Khan*, 522 U.S. 3, 10 (1997)

(emphasis added). Section 1 reaches only "'agreement[s]'" and does not regulate independent decisions. *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 553 (2007) (citation omitted). Accordingly, to prevail, a plaintiff must prove "there was such an agreement"—"'a meeting of minds in an unlawful arrangement.'" *Monsanto Co. v. Spray-Rite Serv. Corp.*, 465 U.S. 752, 763-64 (1984) (quoting *Am. Tobacco Co. v. United States*, 328 U.S. 781, 810 (1946)). Plaintiffs failed to prove these elements, and this Court should reverse.

I. The District Court Erred in Finding Apple Liable for a Price-Fixing Conspiracy

The finding that Apple conspired to fix prices is based on a fundamentally incorrect theory of antitrust liability and disregards the proper legal standard for evaluating the evidence, which required the court to hesitate before inferring conspiracy from conduct that was indisputably in Apple's independent business interests absent a conspiracy. These legal errors require reversal.

A. The District Court's Liability Theory Is Fundamentally Flawed

The court's finding that Apple joined a conspiracy in mid-December 2009 because Apple knew about the publishers' frustrations with Amazon's pricing model and was open-minded about higher prices for e-book new releases contradicts key antitrust principles and embraces an invalid theory of antitrust liability.

1. The District Court's Holding That Apple Joined a Conspiracy in Mid-December 2009 Is Legally Baseless

The court found that "Apple's entry into the conspiracy had to start somewhere, and the evidence is that it started at those initial meetings [on December 15 and 16, 2009,] in New York City with the Publishers." A2278. At those very first meetings, the court found, Apple "willingly joined" a pre-existing publisher conspiracy. A2247; *see also* A2263 ("Apple made a conscious commitment to join a scheme with the Publisher Defendants").

This finding forms the bedrock of the court's entire decision, and is demonstrably wrong. The undisputed record reflects that Apple had no prior dealings in the publishing industry and that everything it knew it had gleaned from public sources—like reports in *The New York Times* and *The Wall Street Journal*—none of which reported on a conspiracy.

The news reports discussed the publishers' frustrations and their efforts to combat Amazon's $9.99 price point. Thus, when Apple first met with individual publishers on December 15-16, 2009, it knew that "all the content owners hate[d] Amazon." A2162 (internal quotation marks omitted). Amazon's dominant position "strengthened [Apple's] hand in proposing [a] new business model to the Publishers." A2172. "Apple seized the moment and brilliantly played its hand." A2145. Mr. Jobs later called this an "'aikido move'" (A2237-38 (alterations

omitted); A891)—a Japanese martial arts maneuver that uses the power of a stronger opponent against itself.

Such a move is not unlawful—it is the essence of competition—and "simply reflect[s] the working of a free market in which [the retailers] have acquired relevant information." *Acquaire v. Canada Dry Bottling Co. of N.Y.*, 24 F.3d 401, 411 (2d Cir. 1994) (internal quotation marks omitted). The articles did not report that the publishers were conspiring and did not prompt the government to challenge the publishers' activities. The district court's assumption (A2129.2430:8-A2130.2431:21; A2249; A2279) that these articles alerted Apple to a publisher conspiracy in mid-December 2009 is wrong as a matter of law and fact. *See Mayor & City Council of Balt. v. Citigroup, Inc.*, 709 F.3d 129, 136 (2d Cir. 2013) ("merely observing parallel conduct among competitors does not necessarily explain its cause").[3]

[3] The district court asserted that "[b]efore Apple even met with the first Publisher Defendant in mid-December 2009, it knew … that Publisher Defendants were already acting collectively to place pressure on Amazon to abandon its pricing strategy" (A2143-44), and that the publishers "were willing to coordinate their efforts" (A2165). But these are simply references to the news articles. A2165. There is no evidence, and the district court did not find, that Apple had knowledge of the phone calls, meetings, and dinners among the publishers featured so prominently in the court's ruling. A2152-54; A2158-59; A2165 n.14.

Indeed, at most the newspaper articles suggested that some publishers were engaging in parallel conduct, but the Supreme Court "has never held that proof of parallel business behavior conclusively establishes … a Sherman Act offense." *Theatre Enters., Inc. v. Paramount Film Distrib. Corp.*, 346 U.S. 537, 541 (1954). This is because "[e]ven conscious parallelism, a common reaction of firms in a concentrated market that recognize their shared economic interests and their interdependence with respect to price and output decisions is not in itself unlawful." *Twombly*, 550 U.S. at 553-54 (internal alterations and quotation marks omitted). "Mere parallelism ... does not even create a *prima facie* conspiracy case." *White v. R.M. Packer Co.*, 635 F.3d 571, 580 (1st Cir. 2011); *see also In re Publ'n Paper Antitrust Litig.*, 690 F.3d 51, 62 (2d Cir. 2012) ("Conscious parallelism alone … does not establish an antitrust violation," as such "behavior is consistent with both unlawful conspiracy and lawful independent conduct"). Accordingly, the publishers' very public parallel conduct cannot be invoked to hold Apple—a stranger to the market—liable for conspiracy.[4]

[4] The district court's "presumed guilty" approach to the publishers typifies the error that permeates its superficial analysis of the conspiracy issue: The district court announced that there was "little dispute that the Publisher Defendants conspired together to raise the prices of their e-books" (A2247), but nowhere identified any agreement among them. The court cited a "common motivation" (A2247) and a series of meetings, calls, and dinners (A2152-54; A2158-59; A2165 n.14), but identified neither when an agreement was reached nor what all five publishers agreed to do.

Nor is there any evidence that Apple reached agreement with any, let alone five, publishers in mid-December. A2167 ("the parties exchanged thoughts about a workable business model"); A2278 (recognizing that "no binding commitments were entered into at these meetings and that a draft contract was not even circulated until weeks after the meetings"). Apple did not reach its distribution agreements with the five publishers until late January. A2167; A2210-12. There was, in short, no "meeting of minds in an unlawful arrangement" (*Monsanto*, 465 U.S. at 764) in December, and the district court's ruling to the contrary is plain legal error.

2. Pricing Discussions and Increased Prices Do Not Convert Lawful Agreements into an Illegal Conspiracy

The lynchpin of the district court's conspiracy ruling is that, even though the agency agreements were lawful, Apple is liable for price-fixing because it discussed prices with the publishers, knew they wanted to raise prices, and entered into agency agreements that allowed the publishers to do so. A2249-50; A2266; A2270-71; A2278-79; A2285. But such pricing discussions between a supplier and distributor are normal, efficient, and lawful, as the Supreme Court, this Court, and other circuits have made clear; they do not convert lawful agreements into a price-fixing conspiracy.

As the district court acknowledged, the actual agreements Apple entered into with the publishers were lawful. A2266-67 ("*[l]awful* distribution

arrangements … include agency arrangements," and "may include an MFN, price caps, or pricing tiers") (emphasis added). Courts have rejected the argument that the agency model (*United States v. Gen. Elec. Co.*, 272 U.S. 476, 488 (1926)) or an MFN (*Blue Cross & Blue Shield United of Wis. v. Marshfield Clinic*, 65 F.3d 1406, 1415 (7th Cir. 1995)) constitute price-fixing. An agency agreement merely replicates the pricing structure of an independent, vertically integrated firm. *See, e.g.*, *Ill. Corp. Travel, Inc. v. Am. Airlines, Inc.*, 806 F.2d 722, 729 (7th Cir. 1986).

Discussions between Apple and the publishers about price do not transform market entry via lawful agreements into unlawful price-fixing. To the contrary, for distributors and suppliers like Apple and the publishers to exchange views on pricing—including "complaints about price-cutters"—is "legitimate," "natural[,] and from the manufacturer's perspective[] unavoidable." *Monsanto*, 465 U.S. at 762-63 (internal quotation marks omitted). Such exchanges "'arise in the normal course of business and do not indicate illegal concerted action.'" *Id.* (citation omitted).

Monsanto held that "the fact that a manufacturer and its distributors are in constant communication about prices and marketing strategy does not alone show that the distributors are [colluding with suppliers]." 465 U.S. at 762. Firms in a vertical business relationship have "legitimate reasons to exchange information about the prices … of their products in the market" (*id.*), and such pricing

discussions may involve "suggestions, persuasion, conversations, arguments, exposition, or pressure" without providing evidence of an unlawful conspiracy (*Acquaire*, 24 F.3d at 410). As a result, as this Court held in *H.L. Hayden Co. of New York, Inc. v. Siemens Medical Systems, Inc.*, 879 F.2d 1005 (2d Cir. 1989), even in the face of "evidence of distributor complaints concerning … pricing levels, … *Monsanto* makes clear that [resulting conduct] does not establish a section one violation." *Id*. at 1014.

Apple had important and valid business reasons to discuss retail prices at its initial meetings with the publishers, as it explored how it could enter the market without losing money. A1759¶13; A1864¶14; A1865¶16; A1876¶44. Apple sought to enter a market dominated by a single retailer and needed to ensure that it could be *competitive* and *profitable*. And it was perfectly lawful for Apple to echo independent analyst reports (A2162) and "*suggest*[] in each meeting" that new release prices might fall "between $11.99 and $14.99" (A2169 (emphasis added)), because, as a prospective distributor, Apple had "legitimate reasons to exchange information about … prices" (*Monsanto*, 465 U.S. at 762). These discussions are evidence of efficient business behavior, not conspiracy or price-fixing.

The discussions were especially benign here, where the court conceded that the "record is equivocal on whether Apple itself desired higher e-book prices than those offered at Amazon." A2285 n.68. Apple's guiding desire was to avoid

launching a lossmaking business, and it therefore insisted on its 30% commission, with which it knew it could be profitable at *any* price point. A2033.1336:3-1337:3; A2094.2050:1-8; A2127.2405:23-2406:6; A1759¶13; A1772¶54; A1790¶110; A1865-66¶17.

The district court did not cite a single case finding a conspiracy where an agent merely enabled its principal to raise price or unwittingly facilitated others' joint conduct. In fact, the Supreme Court has specifically *warned against* assuming that "actions violate the Sherman Act because they lead to higher prices." *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 551 U.S. 877, 896-97 (2007); *see also Brantley v. NBC Universal, Inc.*, 675 F.3d 1192, 1202 (9th Cir. 2012) ("that an agreement has the effect of … increasing prices to consumers does not sufficiently allege an injury to competition" and is "fully consistent with a free, competitive market"). Such actions are commonplace and normally benign because "prices can be increased in the course of promoting procompetitive effects." *Leegin*, 551 U.S. at 895-96. Indeed, the possibility of earning higher prices is "an important element of the free-market system" that "induces risk taking that produces innovation and economic growth." *Verizon Commc'ns Inc. v. Law Offices of Curtis V. Trinko*, 540 U.S. 398, 407 (2004). "Low" or discounted retail prices may deter entry by new outlets and discourage capital investment and the provision of promotional services by existing retailers, all to the *detriment* of

competition. *Leegin*, 551 U.S. at 890-92. "The implications of [the district court's] position are far reaching" (*id.* at 896), and the court's total failure to provide any guidance on the boundaries of permissible conduct when negotiating inherently lawful business models (*e.g.*, A2272), creates enormous uncertainty and confusion that will chill competition and innovation.

The court assumed that Amazon's $9.99 was the *best* retail price and "would have long-term benefits for … consumers" (A2148), condemned Apple for proposing a business model that it knew would likely raise some prices above what the court called "the $9.99 industry *norm*" (A2274 (emphasis added)), and equated a departure from that "norm" with "eliminat[ing] retail price competition" (A2266). The antitrust laws do not, however, favor "better" over "worse" retail prices or enshrine price "norms." And, if anything, "Amazon's choice to sell NYT Bestsellers or other New Releases as loss leaders" (A2291) meant that $9.99 was below the level that is normally deemed competitive. *Barry Wright Corp. v. ITT Grinnell Corp.*, 724 F.2d 227, 232 (1st Cir. 1983) (Breyer, J.) ("competitive industries are typically characterized by prices that are roughly equal to, not below, 'incremental' costs").

The district court was simply incorrect in finding that Apple's "use" of agency and an MFN here amounted to an agreement with the publishers to "eliminate retail price competition." A2266. When Apple entered the market,

there was *no* history of retail price competition: Amazon "dominated" the market and was setting a uniform loss-leader price for the publishers' most important titles, suppressing interbrand competition. A2148. Injection of the agency model enabled Apple to enter and Barnes & Noble (which was facing unsustainable losses) to remain in the market. A1899-900¶50; A1900-01¶¶53-55; A1818¶¶15-17; A2100.2172:7-9; A2100.2174:5-A2101.2175:13; A2101.2178:15-A2102.2179:7. Apple did not enter any agreement requiring any publisher to set any price at any specific amount; rather it opened a bookstore in which thousands of publishers and self-published authors could compete at whatever prices the market would bear subject to lawful price caps and MFNs.

Apple's entry brought enhanced competition with Amazon via catalogue expansion, free e-book offerings, and improved e-reader software. A1893-94¶¶30-32; A1535-45¶¶30-42; A1878-80¶¶49-53; A2290 & n.69. Before Apple's entry Amazon was setting 90% of prices for all brands; afterward, while Amazon continued to use the wholesale model for the bulk of its business (A2234), there were tens of thousands of *new* price-setters in the market. A1897¶¶40-42; SEA45. The result was that although some prices increased, others decreased, and, *across the relevant market, prices on average decreased*. A1885¶4; A1890-91¶¶18-20; A1176.

The district court attempted to squeeze this case into the hub-and-spokes line of cases (A2287), but it does not fit. The "hub" in such a case wields its market power to achieve its own anticompetitive aims. *See Howard Hess Dental Labs. Inc. v. Dentsply Int'l, Inc.*, 602 F.3d 237, 255 (3d Cir. 2010) ("a 'hub-and-spoke' conspiracy … involves a hub, *generally the dominant purchaser or supplier* in the relevant market, and the spokes, made up of the distributors involved in the conspiracy") (emphasis added) (internal citation and quotation marks omitted). But as merely a potential market *entrant*, Apple had no market power to exercise. A2041.1492:18-1493:17.

The "ringmaster" hub defendants in both *Interstate Circuit, Inc. v. United States*, 306 U.S. 208 (1939), and *Toys "R" Us, Inc. v. FTC*, 221 F.3d 928 (7th Cir. 2000) ("*TRU*"), had preexisting market relationships that gave them choke-holds over the alleged horizontal conspirators, such that any refusal to comply with the ringmasters' demands would likely have been devastating. *See Interstate Circuit*, 306 U.S. at 215 & n.2; *TRU*, 221 F.3d at 930-31. Apple, by contrast, had no such leverage. The only "power" it could wield over the publishers was the attractiveness of a potential business opportunity. And far from capitulating to Apple's requested core business terms, the publishers fought Apple tooth and nail to the very end. A513-15; A538; 1675-77¶¶10-14; A1685-89¶¶27-37; A1696-97¶¶20-22; A1698-99¶¶27-28; A1710-13¶¶27-37; A1729¶25; A1730-32¶¶27-31;

A1748-50¶¶34-37; A1780-84¶¶76-90; A2186; A2192-93; A2196-99; A2267; A2274. Indeed, the largest publisher, Random House, declined. A2216. Accordingly, the agreements between Apple and the publishers were not, as a matter of law, a hub-and-spoke conspiracy.

Antitrust laws are intended to foster *competition*, not keep prices down at any cost. *Leegin*, 551 U.S. at 890. Competition is furthered by new entrants that offer innovative business models, diversify the type and number of market players, and increase output. *Brooke Grp. Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 237 (1993) ("Where … output is expanding at the same time prices are increasing, rising prices are equally consistent with growing product demand," and "a jury may not infer competitive injury from price and output data absent some evidence that tends to prove that output was restricted or prices were above a competitive level"); *NCAA v. Bd. of Regents of Univ. of Okla.*, 468 U.S. 85, 103 (1984) (an arrangement that "increase[s] sellers' aggregate output" is "procompetitive"); *BOC Int'l, Ltd. v. FTC*, 557 F.2d 24, 27 (2d Cir. 1977) (in a market dominated by a small number of sellers, "the entry of a large firm as a new competitor necessarily has significant procompetitive effects," including "'shak(ing) things up' or engendering 'competitive motion'") (citations omitted); *see also*, *e.g.*, *Yamaha Motor Co. v. FTC*, 657 F.2d 971, 979 (8th Cir. 1981) ("Any new entrant of Yamaha's stature would have had an obvious procompetitive effect

leading to some deconcentration"). That is exactly what Apple's agency agreements with thousands of publishers and self-published authors fostered here, and the district court's holding that those lawful agreements amounted to an unlawful conspiracy was reversible error.

B. The District Court Applied the Wrong Legal Standards for Evaluating Evidence in a Conspiracy Case

The district court's evaluation of the evidence contradicts the "stringent standards" (*Leegin*, 551 U.S. at 903) the Supreme Court has established in price-fixing cases. Evidence of price-fixing must "show that the inference of conspiracy is reasonable in light of the competing inferences of independent action." *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 588 (1986). The evidence must "tend[] to exclude the possibility that the [defendants] were acting independently." *Monsanto*, 465 U.S. at 764; *Twombly*, 550 U.S. at 554. Instead of the *Monsanto* framework, the court viewed the record through the conspiracy lens, which distorted its entire analysis. This legal error infected all of the court's conclusions and requires reversal.

"A major concern underlying antitrust jurisprudence lies in the fear of mistakenly attaching antitrust liability to conduct that in reality is the competitive activity the Sherman Act seeks to protect." *Int'l Distrib. Ctrs., Inc. v. Walsh Trucking Co.*, 812 F.2d 786, 795 n.8 (2d Cir. 1987). That is exactly what happened here.

1. The District Court Disregarded the "Stringent Standards" Limiting Inferences in a Conspiracy Case

When, as here, direct and unambiguous proof of a conspiracy is lacking, a vital safeguard against the danger of mistaking legitimate conduct for a conspiracy is that the Sherman Act "limits the range of permissible inferences from ambiguous evidence." *Matsushita*, 475 U.S. at 588. "Permitting an agreement to be inferred" from ambiguous evidence "could deter or penalize perfectly legitimate conduct" and "create an irrational dislocation in the market." *Monsanto*, 465 U.S. at 763-64; *see also White*, 635 F.3d at 577 (*Monsanto* "evidentiary standards [developed] to minimize the risk that legal conduct will be chilled or punished").

It is therefore "of considerable importance" that ambiguity in the evidence be recognized and "that independent action … and concerted action on nonprice restrictions, *be distinguished from price-fixing agreements*." *Monsanto*, 465 U.S. at 763 (emphasis added). Otherwise, the line dividing legal and illegal conduct is blurred, violating the "fundamental principle in our legal system … that laws which regulate persons or entities must give fair notice of conduct that is forbidden." *FCC v. Fox Television Stations, Inc.*, 132 S. Ct. 2307, 2317 (2012). The district court's standardless, incoherent approach violates these important principles.

As this Court has recognized, *Monsanto* requires that once a defendant establishes its conduct "is consistent with permissible activity," the plaintiff must

"come forward with evidence 'that tends to exclude the possibility of independent action.'" *H.L. Hayden*, 879 F.2d at 1014 (quoting *Monsanto*, 465 U.S. at 768); *see also Publ'n Paper*, 690 F.3d at 63 ("where a plaintiff's theory of recovery is implausible, it takes 'strong direct or circumstantial evidence' to satisfy *Matsushita*'s 'tends to exclude' standard") (citation omitted); *Market Force Inc. v. Wauwatosa Realty Co.*, 906 F.2d 1167, 1171 (7th Cir. 1990) (setting forth same burden-shifting framework); *Richards v. Neilsen Freight Lines*, 810 F.2d 898, 902 (9th Cir. 1987) (same). And the plaintiff's evidence must be especially strong when the defendant acted in furtherance of its independent business interests—that is, where the defendant "behave[ed] in a manner that would be rational (*i.e.*, that would increase [its] profits or net worth) absent a collusive agreement." ABA Section of Antitrust Law, *Proof of Conspiracy Under Federal Antitrust Laws* 224 (2010).

The district court paid mere lip service to these principles, derisively labeling the "'tends to exclude' formulation [of *Monsanto*] as the crown jewel of [Apple's] defense." A2259. The court ignored that "what constitutes a reasonable inference in the context of an antitrust case … is somewhat different from cases in other branches of the law in that 'antitrust law limits the range of permissible inferences from ambiguous evidence in a § 1 case.'" *In re Baby Food Antitrust Litig.*, 166 F.3d 112, 124 (3d Cir. 1999); *see also H.L. Hayden*, 879 F.2d at 1016

(referring to "the special requirements of the *Monsanto-Matsushita* rule for section one conspiracies"); *White*, 635 F.3d at 577 ("special rules"). In doing so, the court violated this Court's admonition "that proof problems regarding antitrust conspiracies are remedied by *the close judicial scrutiny applied to evidence of their existence*." *Int'l Distrib. Ctrs.*, 812 F.2d at 795 n.8 (emphasis added).

To place proper limits on the inferences from ambiguous evidence in a section 1 case, a fact-finder must recognize when the evidence *is* ambiguous in the first place. This Court in *H.L. Hayden*, for example, held that a lunch between two alleged co-conspirators, which resulted in a follow-up letter acknowledging discussion of the parties' "philosophies concerning the distribution in the industry" and assuring the alleged co-conspirator they "would do everything in our power to offer you the best possible market environment," was "*ambiguous at best* in terms of proving any illegal combination or conspiracy," and therefore held that such evidence could not establish a conspiracy. 879 F.2d at 1015-16 (emphasis added) (internal quotation marks omitted).

The district court here blinded itself to the ambiguity in the evidence. Instead, even while it expressly recognized that "Apple chose to further its own independent, economic interests" (A2264; A1749-50¶37; A1862¶8; A1864¶14), the court held that "Apple's independent business reasons for creating an e-bookstore and for adopting an agency model to do so *have not created any*

ambiguity in the evidentiary record that should require hesitation before finding Apple liable." A2268 (emphasis added); *see also* A2260 ("[Apple] also perceives ambiguity where none exists"); A2265 ("To the extent that Apple is arguing that the evidence of its participation with the Publisher Defendants in the conspiracy is ambiguous, it is wrong"). That is precisely, and legally, incorrect.

The district court's own findings *compelled* recognition of ambiguity. The court expressly found that a non-conspirator *could have legally engaged in the same conduct as Apple*, including using the same simultaneous negotiating tactics to enter into the same agency agreements that included the same price tiers with caps and MFN provisions. A2266; A2291. This goes to the heart of the Supreme Court's concerns about "the ambiguity of the behavior: consistent with conspiracy, but just as much in line with a wide swath of rational and competitive business strategy." *Twombly*, 550 U.S. at 554; *see also*, *e.g.*, *Monsanto*, 465 U.S. at 762 (when "judged from a distance, the conduct of the parties" in a conspiracy "can be indistinguishable" from unilateral conduct).

Any doubt that the district court applied the wrong legal framework is dispelled by its reliance on the statement in *United States v. General Motors Corp.*, 384 U.S. 127, 142 (1966), that "*it is of 'no consequence*, for purposes of determining whether there has been a combination or conspiracy under s[ection] 1 of the Sherman Act, *that each party acted in its own lawful interest*.'" A2264-65

(emphases added). *General Motors* predates *Monsanto*, as well as *Matsushita*, which clarified that it is of great consequence when challenged conduct is "consistent with the defendant's independent interest." 475 U.S. at 587. As the Court in *Monsanto* declared, "there is the basic distinction between concerted and independent action—a distinction not always clearly drawn by parties and courts…. Independent action is not proscribed." 465 U.S. at 761.

In erroneously finding that "Apple's independent business reasons" required no "hesitation before finding Apple liable," the district court also relied on its review of the "totality of the evidence." A2267-69. But as this Court has held, review of "the totality of the evidence" must be accomplished "with *proper regard* for the *Matsushita* standards." *Publ'n Paper*, 690 F.3d at 64 (emphasis added). This Court has repeatedly "overturned jury verdicts where, taken as a whole, the evidence pointed with at least as much force toward unilateral action by the defendants as toward conspiracy, and a jury would have to engage in impermissible speculation to reach the latter conclusion." *H.L. Hayden*, 879 F.2d at 1014 (internal quotation marks omitted); *see also Int'l Distrib. Ctrs.*, 812 F.2d at 794 (same). Here the evidence points with at least as much force toward unilateral action as to conspiracy.

In short, while the district court found that Apple's "independent business reasons" created no ambiguity that would "require hesitation before finding Apple

liable" (A2268), under *Monsanto* and its progeny, the fact-finder is *required* to hesitate under exactly these circumstances. The district court's express refusal to do so requires reversal.

2. The District Court's Inference of Conspiracy Flowed from Its Misinterpretation of the Proper Legal Standards

The district court found that "the Plaintiffs have shown … through compelling direct and circumstantial evidence that Apple participated in and facilitated a horizontal price-fixing conspiracy." A2254. The court's findings result from application of the wrong legal framework, and should therefore be reversed.

a. There was no direct evidence of conspiracy. The district court professed to have found "powerful *direct* evidence" of a price-fixing conspiracy (A2264 (emphasis added)) on par with "'a recorded phone call in which two competitors agreed to fix prices at a certain level'" (A2242 (quoting *Mayor & City Council of Balt.*, 709 F.3d at 136)). This was error, because unlike the ambiguous communications at issue here, "[d]irect evidence of a conspiracy is that which *explicitly refer[s] to an understanding* between the alleged conspirators." *Viazis v. Am. Ass'n of Orthodontists*, 314 F.3d 758, 762 (5th Cir. 2002) (emphasis added) (internal citation and quotation marks omitted); *Godwin v. Hunt Wesson, Inc.*, 150 F.3d 1217, 1221 (9th Cir. 1998) ("Direct evidence is evidence which, if believed, proves the fact … without inference or presumption") (internal citation and

quotation marks omitted). Direct evidence of conduct that is merely *consistent* with a conspiracy can only be *circumstantial* evidence of a conspiracy. *See Matsushita*, 475 U.S. at 595-96.

In *Monsanto*, for example, the "substantial *direct* evidence of agreements to maintain prices" was testimony from a Monsanto employee that distributors agreed to maintain resale prices in exchange for continuing to receive Monsanto's product. 465 U.S. at 765. Likewise, in *Publication Paper*, a co-conspirator who had been granted immunity from criminal prosecution testified that he reached an "'agreement'" to follow the other conspirator's price increase "to the fullest extent possible," and even that evidence was not deemed by this Court either direct or unambiguous. 690 F.3d at 64; *see also United States v. Taubman*, 297 F.3d 161, 165 (2d Cir. 2002) (direct evidence of a price-fixing conspiracy consisted of CEO's testimony that "she was directed by [the Chairman of the Board] to meet with [the CEO of the firm's rival] and work out the specifics of the price-fixing agreement"). These cases might have been relevant here had the publishers pleaded guilty and then testified that they conspired with Apple to fix prices; instead, the publisher defendants settled without admitting liability (A1117; A1824; A2388), and the publisher executives all testified at trial that there was no conspiracy.

The communications the district court considered "direct" evidence of conspiracy (A2253; A2264-66) were actually circumstantial and exceedingly ambiguous. For example, Mr. Jobs's statement to a reporter that the price of an e-book sold by Apple "'will be the same'" as the same e-book sold by Amazon for $9.99 (A2219) was most reasonably viewed as a reference to the MFN, but the district court assumed the worst—that it referenced a conspiracy (A2220)—even though Mr. Jobs died in 2011 and thus could not explain his statements. *Cf. Apple Inc. v. Motorola Inc.*, No. 11-cv-8540, slip op. at 4-8 (N.D. Ill. May 24, 2012) (excluding "any reference to Isaacson's biography of Jobs" "unless you want to have a séance and try to question him on the other side"). Mr. Jobs's email to Mr. Murdoch in fact refutes the existence of a price-fixing conspiracy, but the court rejected those portions (*e.g.*, "where [Mr. Jobs] muses about Amazon's $9.99 price point, 'who knows, maybe they are right'") in favor of the court's own interpretation. A2284. And the fact that Mr. Jobs knew in late January that the publishers might use windowing to fight back against Amazon (A2219-20) was hardly breaking news as it had been reported in leading newspapers six weeks earlier (A2157-58).

None of the communications between Apple and the publisher executives that the court referenced (A2174; A2179; A2206; A2252) evidenced a conspiracy with the publishers.

For example, based on an innocuous email from Mr. Cue to Ms. Reidy of Simon & Schuster complimenting Reidy as a "real leader of the book industry" (A621), the court inferred that "Cue appreciated all that Reidy had done to convince her peers to join forces with Apple at several critical junctures" (A2217). The testimony directly contradicted this speculation (A1997.526:21-23; A2084.1975:14-18; A2084.1976:17-21), and no evidence supports it. The court inferred that reference to "[t]he stumbling block" in an email from Mr. Sargent of Macmillan to Mr. Cue (A545) meant "the commitment to move all resellers of e-books to an agency model" (A2205) even though the testimony (A2017.1122:5-A2019.1128:17; A2025.1177:4-A2027.1184:20; A2066.1747:2-A2067.1750:18; *see also* A2032.1269:17-1270:3; A2076.1847:2-16) and contemporaneous documents (A539-40) directly refuted the court's interpretation. And from an email from Mr. Sargent to Mr. Cue stating that on "Friday, I … suspect I will be in Seattle or traveling back" (A588), the court inferred that Apple knew that all the publishers would "demand that Amazon move to an agency model" (A2218 & n.47). No testimony supported the court's conclusion that Sargent had told Cue that his trip to Seattle was to demand that Amazon adopt an agency model (much less that he conveyed anything about other publishers' plans), and the testimony was entirely to the contrary. A2021.1146:10-1147:4; A2059.1709:23-A2060.1710:9; A2070.1773:7-10; A2078.1896:13-20.

These emails exchanged with individual publishers including nothing but friendly banter among business partners are "ambiguous at best," and the district court's findings based thereon are "nothing beyond surmise." *H.L. Hayden*, 879 F.2d at 1015-16.

Finally, the district court's conjecture about the content of a "web of telephone calls" (A2253 & n.59; A2294) between *other parties* (not Apple) is not remotely tantamount to a "'recorded phone call in which two competitors agreed to fix prices at a certain level.'" A2242 (quoting *Mayor & City Council of Balt.*, 709 F.3d at 136). The court did not listen to these calls because they were not recorded, but rather drew conspiratorial inferences (contrary to the testimony) about them based on content-free phone records (A2164-65 & n.14; A2253 n.59) and barred testimony that would have explained them (A2001.610:22-611:12 (disallowing Ms. Reidy to "comment" on the phone calls)).

b. The circumstantial evidence is highly ambiguous at best. The district court found nothing that "require[d] hesitation" (A2268) before drawing conspiratorial inferences from ambiguous circumstantial evidence and parallel negotiations that were necessary to introducing a new platform (A1871-72¶¶30-33). In doing so, the court reached clearly erroneous conclusions based on undisputed facts. A few examples:

First, although acknowledging agency was a lawful business model (A2266), the district court treated Apple's decision to offer the publishers "the opportunity to move from a wholesale model … to an agency model" (A2145) as a *continuation* of the price-fixing conspiracy Apple supposedly joined in mid-December 2009 (A2278). The court made this connection because "[a]gency would give the Publishers the control over e-book pricing that they desired." A2173. The court's finding compounded its prior error (finding Apple joined a conspiracy in December) and ignored the fact that shifting price control is an essential attribute of *all* agency arrangements.

Competition was not "destroyed" (as the district court asserted) when the "agency model for the distribution of e-books[] removed the ability of retailers to set the prices of their e-books." A2255. To the contrary, this is what agency *does*. *See*, *e.g.*, A1761-62¶19. When distributors act as agents, they compete but do not set prices. This essential characteristic does not mean—as the district court assumed—that agency is "some massive evasion of the rule against price fixing" (*Morrison v. Murray Biscuit Co.*, 797 F.2d 1430, 1437 (7th Cir. 1986)); rather, "as a matter of principle," "genuine contracts of agency" are not "violations of the Anti-Trust Act" (*United States v. Gen. Elec. Co.*, 272 U.S. 476, 488 (1926); *see also Valuepest.com of Charlotte, Inc. v. Bayer Corp.*, 561 F.3d 282, 288 (4th Cir. 2009) ("*General Electric* holds that a principal-agent relationship is not an

agreement for antitrust purposes"); *Day v. Taylor*, 400 F.3d 1272, 1276 (11th Cir. 2005) (same)).

Second, the district court conceded that imposing maximum *caps* on e-book prices was in Apple's independent business interests, logical, and not "wrongful." A2266 ("entirely lawful contracts may include … price caps"); A2291 ("this Court has not found that [pricing tiers with caps] were wrongful"); *see also* A1773-74¶57; A1866-67¶¶18-21. Nonetheless, the court condemned the price caps without hesitation as horizontal price-fixing because of "the context of the[] overarching agreement to raise prices above the $9.99 industry norm." A2274. This too was a legally impermissible inference.

Apple's efforts were the *antithesis* of anti-competitive, conspiratorial conduct. As the court itself conceded, "[i]t is true that the Publisher Defendants pushed for [higher] price caps" (A2274); indeed, they "fought hardest over the price caps" (A2193), which Apple "fiercely negotiated" (A2267). "Despite their efforts, the Publisher Defendants achieved only modest adjustments to the price caps" (A2196), and were left unhappy. A2197-99 (Apple sought to "'push [the Publisher Defendants] to the very edge'"). There is not a scintilla of evidence that Apple negotiated other than bilaterally or had any knowledge of coordination on price caps among the publishers.

Yet despite its concession of *ambiguity* (A2285 n.68) and despite holding that it was "*not illegal*" for Apple to "negotiate with all suppliers at the same time" over a necessarily uniform contract term (A2266 (emphasis added)), the district court leapt to the inference that negotiating in parallel to impose unwanted price caps was nothing more than continuing "'to negotiate some details of the conspiracy with the cartel members'" (A2273-74 (quoting *United States v. Andreas*, 216 F.3d 645, 679-80 (7th Cir. 2000) (interpreting criminal sentencing guidelines))). This was another clear instance of ignoring the *Monsanto* standard and penalizing independent procompetitive conduct.

Third, the court relied on the MFN clauses in the agency agreements as proof of horizontal price-fixing. A2267. This inference was legally impermissible.

The district court conceded that the MFN clause in Apple's agency agreements was in Apple's independent business interests, logical, and not "wrongful." A2265-66; A2291; *see also* A2146 (MFN "protected Apple by guaranteeing it could match the lowest retail price listed on any competitor's e-bookstore"); A2272 ("The MFN did lower the prices in the iBookstore below the price caps set in the tiers if a Publisher did not immediately move its other resellers to an agency arrangement"); A1776-77¶¶65-66; A1868-70¶¶22-29; Tr.1596:9-10 (plaintiffs' expert admitting that "it makes sense for Apple to want to have price parity"). Indeed, with the publishers setting retail prices for Apple as its agent, the

only way Apple could be competitive with other retailers was to guarantee its ability to match any lower prices being charged by other retailers, and the MFN gave it the ability to do so. A556 (Apple commenting on Hachette's January 20, 2010 edits to the proposed contract that removing the MFN "GUTS OUR ABILITY TO COMPETE"); *see*, *e.g.*, *In re Online Travel Co. Hotel Booking Antitrust Litig.*, 2014 WL 626555, at *9 (N.D. Tex. Feb. 18, 2014) (refusing to infer conspiracy from an MFN because "[h]aving given up the right to discount prices …, each … Defendant would naturally want an assurance that competitors will also be prohibited from offering a lower price than the published rate"); *see also Murray Biscuit*, 797 F.2d at 1437 (an agent's lack of "interest in or capacity for setting the retail prices of … goods … is not inconsistent with his being concerned about underpricing").

And far from being embraced by all the alleged conspirators as the cornerstone of their conspiracy, the publishers actively resisted the MFN. A514; A1675¶11; A1687-88¶¶30-31; A1710-12¶¶29-31; A1731¶30; A1778-79¶72; A1782-83¶84; A1783-84¶88. The MFN constituted a "compromise" that, when combined with the agency model, "allowed Apple to achieve its business goals whether prices were the same, higher or lower than their historical level." A1869-70¶¶26-27.

MFNs are "standard devices by which buyers try to bargain for low prices, by getting the seller to agree to treat them as favorably as any of their other customers." *Marshfield Clinic*, 65 F.3d at 1415. This is "the sort of conduct that the antitrust laws seek to encourage"; "it is not price fixing." *Id.* Indeed, before this trial, no court had ever condemned use of an MFN clause as illegal. *See* 1 ABA Section of Antitrust Law, *Antitrust Law Developments* 223 (7th ed. 2012).

The district court's reasoning was *not* that the MFN fixed prices, but that "[t]he economics of the Agreements" made it "sufficient to force the change in model" from wholesale to agency. A2250-51. According to the court, the MFN "literally stiffened the spines of the Publisher Defendants to ensure that they would demand new terms from Amazon" (A2189) by imposing a "severe financial penalty" (A2146) on any publisher that did not move Amazon to agency.

But the court's findings on "the economics of the Agreements" (A2251) and "financial penalt[ies]" (A2146) should have been (yet were not) based on *economic analysis*. As a matter of economics, an MFN can compel market conduct only when imposed by a dominant firm holding market power due to its large market share. As the senior DOJ official who signed the complaint initiating this case said: "It's not that all MFNs lead to competitive harm. But we take a close look at them when employed by firms with significant market power." Interview with Sharis A. Pozen, The Antitrust Source 7 (April 2012), *available*

at http://www.americanbar.org/content/dam/aba/publishing/antitrust_source/apr12_full_source_4_26f.authcheckdam.pdf; *compare*, *e.g.*, *United States v. Blue Cross Blue Shield of Mich.*, 809 F. Supp. 2d 665, 673-74, 675 (E.D. Mich. 2011) (DOJ alleged defendant, who admitted it was "dominant," held market power given geographic market shares "from 40% to more than 80%").

Dr. Benjamin Klein was the sole expert who *quantified* the MFN "penalty" theory as a matter of mathematics. A1798-99¶¶15-16. Because of Apple's low market share and the fact that the MFN applied to only a subset of the publishers' titles, "the actual effect of the Apple MFN" was "*less than one percent* of publisher sales." A1800¶22 (emphasis in original); *see also* A2097.2126:1-14; A1172-74; A1868-69¶25. As such, the "economic effects of the Apple MFN on publishers [were] so demonstrably small that it is an economic fiction to claim that such effects compel[led] or control[led] publisher conduct vis-à-vis Amazon." A1794¶5.

The district court ignored Prof. Klein's testimony and conducted no objective evaluation of the MFN "penalty" theory. A2358:23-A2359:4 ("This is not one of those cases in which expert testimony was a princip[al] driver of a decision"). Instead, the court relied on inferences based on ambiguous and speculative evidence, such as emails regarding Apple's alleged intent (A2182-83) and publisher testimony about what the "MFN meant" (A2190). This was error because "*competent* evidence is necessary to allow a reasonable inference that [the

challenged conduct] poses an authentic threat to competition." *Brooke Grp.*, 509 U.S. at 232 (emphasis added). Here, the MFN clauses were supported by valid independent business reasons, and the *objective* evidence revealed that they conferred no "power" on Apple to compel the publishers to take unwanted action.

Moreover, even the non-economic evidence did not permit the inference that the MFN was intended to carry out a conspiracy. The district court, although asserting that "there is no evidence that Apple ever communicated to any of the Publisher Defendants that they were free to leave their other retailers of e-books on a wholesale model" (A2184), acknowledged that "Apple dropped from the agency contract it was drafting the explicit requirement that had appeared in its term sheet that all e-tailers be placed on an agency model" (A2183).

Thus, when Random House asked in mid-January 2010, Apple confirmed what its draft contract showed—that "it could accept a hybrid model where Random House moves to agency with Apple but stays on wholesale with some retailers" without windowing its e-books. A2183-84; A2076.1847:10-16; A1552¶13; A500-01 (internal Random House email indicating that Apple was "willing to consider an agency model for RH even if no other retailers also convert to agency"). Both HarperCollins and Macmillan successfully negotiated various exceptions to the MFN that contemplated their keeping other retailers on the wholesale model. A2013.1032:1-14; A2015.1051:18-25. And Apple had agency

agreements with MFNs with other publishers who remained on wholesale with Amazon. A1868¶23; A2006.835:10-A2007.838:8; *see also* A1531¶19; A2234.

The court disregarded the economic and documentary evidence, instead finding that Apple "did not change its thinking" (A2183) and "achieved the same end by means of the MFN" (A2273). In adopting this position, the court confirmed (again) that far from assessing whether the evidence "tend[ed] to exclude the possibility that the [defendants] were acting independently" (*Monsanto*, 465 U.S. at 764), it erroneously required Apple to "construct a persuasive alternative reading of [the circumstantial] evidence" (A2277) that *disproved* the court's presumption that Apple's conduct was conspiratorial.

* * *

The district court committed legal error when it found that Apple's use of indisputably lawful agency agreements amounted to a conspiracy to fix prices because the agency model gave publishers pricing authority and Apple knew the publishers wanted to raise prices on some e-books. *Leegin*, 551 U.S. at 896-97; *Monsanto*, 465 U.S. at 763. Moreover, when the evidence is evaluated "in light of the competing inferences of independent action," as the Supreme Court requires (*Matsushita*, 475 U.S. at 588), it is clear that judgment should be entered for Apple.

II. The District Court's Application of the *Per Se* Rule and the Rule of Reason Were Legally Incorrect

The district court found *per se* liability because "Apple participated in and facilitated a horizontal price-fixing conspiracy" (A2254), and in a single paragraph stated that Apple would also be liable under the rule of reason (A2255-56). Both findings were premised on legal error.

A. The District Court Incorrectly Invoked the *Per Se* Rule

"Resort to *per se* rules is confined to restraints … that would always or almost always tend to restrict competition," have "manifestly anticompetitive effects," and lack "any redeeming virtue." *Leegin*, 551 U.S. at 886 (internal citations and quotation marks omitted); *In re Sulfuric Acid Antitrust Litig.*, 703 F.3d 1004, 1011-12 (7th Cir. 2012) ("The *per se* rule is designed for cases in which experience has convinced the judiciary that a particular type of business practice has no (or trivial) redeeming benefits ever"). In the increasingly limited circumstances in which it applies, the *per se* rule is "based on business certainty and litigation efficiency": "It represents a longstanding judgment that the prohibited practices" are anticompetitive "*by their nature*," and is appropriate only where "experience with a particular kind of restraint enables the Court to predict with confidence that the rule of reason [would] condemn it." *Atl. Richfield Co. v. USA Petroleum Co.*, 495 U.S. 328, 342 (1990) (emphasis added) (internal citations and quotation marks omitted).

The Supreme Court has "'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.'" *Leegin*, 551 U.S. at 887 (quoting *Khan*, 522 U.S. at 10). This is because the *per se* rule "can be counterproductive … by prohibiting procompetitive conduct the antitrust laws should encourage." *Leegin*, 551 U.S. at 895. "[V]ertical restrictions," in particular, are subject to the rule of reason and not the *per se* rule "because of their potential for a simultaneous reduction of intrabrand competition and stimulation of interbrand competition." *Cont'l T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 51-52, 59 (1977); *see also Leegin*, 551 U.S. at 891 (vertical price restraints "can increase interbrand competition by facilitating market entry for new firms").

The district court, citing only its own previous decision in the related class action, found the *per se* rule applies because the challenged agreement was "'at root, a horizontal price restraint.'" A2287 (quoting *In re Elec. Books Antitrust Litig.*, 859 F. Supp. 2d 671, 685 (S.D.N.Y. 2012)). But the Supreme Court has rejected precisely this sort of relabeling of the nature of the agreements. *Bus. Elecs. Corp. v. Sharp Elecs. Corp.*, 485 U.S. 717, 730 & n.4 (1988) (rejecting dissent's "belie[f] that whether a restraint is horizontal depends upon whether its anticompetitive effects are horizontal, and not upon whether it is the product of a horizontal agreement") (emphasis omitted). "Restraints imposed by agreement

between competitors have traditionally been denominated as horizontal restraints, and those imposed by agreement between firms at different levels of distribution as vertical restraints." *Id.* at 730. Apple's agreements with the publishers were *vertical* agreements that in no way set prices or otherwise limited competition among the (horizontal) publishers, and are therefore governed by the rule of reason. *Leegin*, 551 U.S. at 907; *Khan*, 522 U.S. at 17-18; *Bus. Elecs.*, 485 U.S. at 730; *see also Major League Baseball Props., Inc. v. Salvino, Inc.*, 542 F.3d 290, 320 (2d Cir. 2008) (in the absence of "an agreement with respect to the prices to be charged …, the so-called 'price' restriction is not in fact an agreement on 'price' but rather an agreement for the sharing of profits," and therefore subject to the rule of reason).

The price caps *restricted* prices "'as protection against excessively high prices that could either alienate [Apple's] customers or subject [it] to ridicule.'" A2199. And the Supreme Court held in *Khan* that agreements on price caps *cannot* be condemned under the *per se* rule even if the caps are in effect price minimums. 522 U.S. at 17.

The hub-and-spokes cases do not allow application of the *per se* rule. *Interstate Circuit* was not even a *per se* case. *See* 306 U.S. at 230-32; *see also Royal Drug Co. v. Grp. Life & Health Ins. Co.*, 737 F.2d 1433, 1437 (5th Cir. 1984) ("the Supreme Court's analysis [in *Interstate Circuit*] was predicated upon the rule

of reason"). *TRU*, 221 F.3d 928, involves vastly different facts and predates *Leegin* by several years. *See also supra* pp. 26-27.

Moreover, even if (contrary to the evidence) Apple coordinated coalescence on the agency model for five publishers, such conduct would nonetheless be "governed by the rule of reason, rather than being *per se* illegal, if the challenged practice when adopted could reasonably have been believed to promote 'enterprise and productivity.'" *Sulfuric Acid*, 703 F.3d at 1011; *see also Toledo Mack Sales & Serv., Inc. v. Mack Trucks, Inc.*, 530 F.3d 204, 225 (3d Cir. 2008) ("the rule of reason analysis applies even when ... the plaintiff alleges that the purpose of the vertical agreement between a manufacturer and its dealers is to support illegal horizontal agreements between multiple dealers") (citing *Leegin*, 551 U.S. at 893); *Gorlick Distrib. Ctrs., LLC v. Car Sound Exhaust Sys., Inc.*, 723 F.3d 1019, 1025 (9th Cir. 2013). This is because departure from the presumptive rule-of-reason standard "must be justified by demonstrable economic effect." *Bus. Elecs.*, 485 U.S. at 726; *see also Broad. Music, Inc. v. Columbia Broad. Sys., Inc.*, 441 U.S. 1, 9 (1979) (merely characterizing a practice as "price fixing" does "not alone establish that this particular practice is ... 'plainly anticompetitive' and very likely without 'redeeming virtue'"). The agreements in both *Interstate Circuit* (306 U.S. at 231) and *TRU* (221 F.3d at 938) were unaccompanied by any remotely procompetitive business activity.

There can be no serious claim that Apple's entry with the iBooks Store into a market "dominated" by Amazon, which was "selling nearly 90% of all e-books" through 2009 (A2148), lacked *any* redeeming virtue, a necessary condition for application of the *per se* rule.[5]

The district court acknowledged, for example, that it "is true" that the "iBookstore created another e-retailer" and that "having the creativity and commitment of Apple invested in the enhancement of a product like the iBookstore *is extremely beneficial to consumers and competition*." A2290 & n.69 (emphasis added); *see also* A2199 (Apple imposed price caps "as protection against excessively high prices that could either alienate [its] customers or subject [it] to ridicule") (internal quotation marks omitted). Apple entered and sold millions of e-books to consumers as a result of its agency agreements with the major

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[5] The pro-competitive effects of Apple's entry have been widely recognized. *See*, *e.g.*, George Packer, "Cheap Words," The New Yorker, Feb. 17, 2014 ("before the feds stepped in, the agency model introduced competition to the market"), *available at* http://www.newyorker.com/reporting/2014/02/17/140217fa_fact_packer?currentPage=all; Editorial, *The E-Book Price Fixing Conspiracy*, N.Y. Times, July 13, 2013 (Apple's agency agreements with the publishers "brought much-needed competition to the e-book marketplace ... that is healthier for the publishers and for consumers, too"), *available at* http://www.nytimes.com/2013/07/13/opinion/the-e-book-price-fixing-conspiracy.html?_r=0; Editorial, *Guilty of Competition*, Wall St. J., July 11, 2013 (district court's decision a "threat to competition and efficient markets"), *available at* http://online.wsj.com/news/articles/SB10001424127887324879504578597883383524650.

publishers and thousands of publishers and self-published authors—an undeniable procompetitive benefit. A1526¶8; A1893-94¶¶29-32; A1184; A1789-90¶108. The relevant market in the post-agency period was marked by continued robust growth in output (A1893-94¶¶29-31; SEA44), more choice in titles (A1185; A1533-34¶¶24-26), and greater quality and innovation (A2290 & n.69; A1535-44¶¶30-39).

Apple's entry eliminated the threat of windowing, which the plaintiffs deemed a "restriction on output to the detriment of consumers" (A967¶56), and which plaintiffs' expert described as an "infinite price increase" (A1638¶204). Prior to Apple's entry, Amazon was the only dominant price-setter, and Barnes & Noble was facing unsustainable losses (A1818¶¶15-17; A2100.2172:7-9; A2100.2174:5-A2101.2175:13; A2101.2178:18-A2102.2179:7); shortly after, there were thousands of publishers establishing prices in competition with each other (A2115.2295:17-21). The average retail price of e-books in the relevant market was lower during the post-agency period than during the pre-agency period. A1890-91¶18. Effective wholesale prices for the major publishers declined as well. A1892¶24.

Moreover, the district court recognized the innovation to e-reading resulting from Apple's entry: "In contrast to the black-and-white e-reader devices on the market at the time, the iPad [had] the capacity to display not only e-book text but also e-book illustrations and photographs in color on a backlit screen. The iPad …

[had] audio and video capabilities and a touch screen." A2162-63. "[T]he Launch of the iPad, a revolutionary device," has "encouraged innovation and competition" (A2290), and the iBooks Store provided "a dramatic component of the Launch" (A2163).

In light of this evidence, it is anything but "immediately obvious" (*Major League Baseball*, 542 F.3d at 316 (citation omitted)) that Apple's market entry was anticompetitive. The district court's reliance on the *per se* rule to automatically condemn entry—an act that is "essential to a dynamic economy" (*Leegin*, 551 U.S. at 891)—is reversible error.

Moreover, the *per se* rule can be applied only where "experience with a particular kind of restraint enables the Court to predict with confidence that the rule of reason [would] condemn it." *Atl. Richfield*, 495 U.S. at 342; *see also Sulfuric Acid*, 703 F.3d at 1011 ("It is a bad idea to subject a novel way of doing business (or an old way in a new and previously unexamined context …) to *per se* treatment under antitrust law"). But to the extent courts have "considerable experience" with the different restraints in this case, it has led courts to apply the rule of reason, rather than the *per se* rule, to MFNs (*e.g.*, *Marshfield Clinic*, 65 F.3d at 1415), vertical distribution agreements (*e.g.*, *Leegin*, 551 U.S. at 886-87), and price caps (*e.g.*, *Khan*, 522 U.S. at 17-18). And the lack of *any* judicial

experience with plaintiffs' novel and intricate theory compels application of the rule of reason.

B. The Legal Errors in the Court's One-Paragraph Rule-of-Reason Analysis Require Reversal

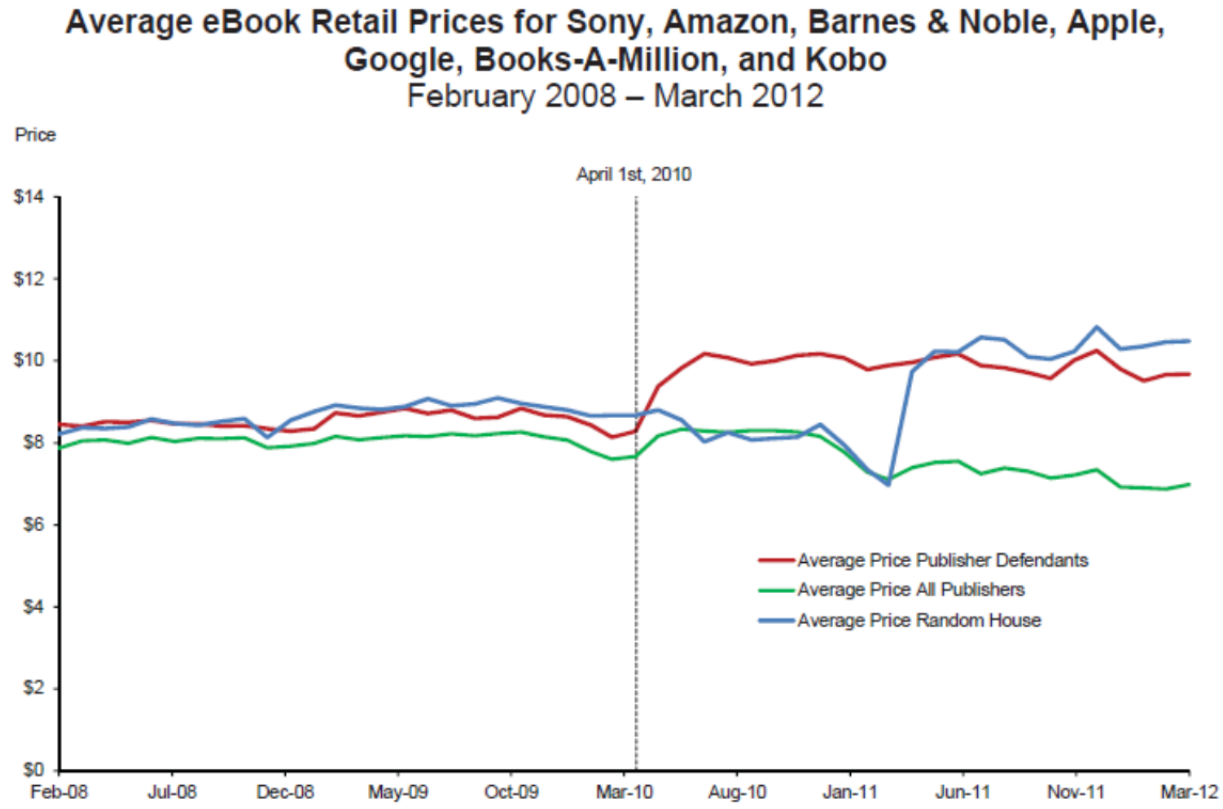
The district court's one-paragraph alternative holding that Apple's agency agreements violated the rule of reason does not amount to the "careful and complete analysis of the competitive effects of the challenged restraint" that is required by law (*Capital Imaging Assocs., P.C. v. Mohawk Valley Med. Assocs., Inc.*, 996 F.2d 537, 543 (2d Cir. 1993)), and is replete with error.

Under the rule of reason, the "plaintiff bears the initial burden of showing that the challenged action has had an *actual* adverse effect on competition as a whole in the relevant market." *Capital Imaging*, 996 F.2d at 543; *see also Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 31 (1984) (liability under rule of reason rejected given "no showing that the market as a whole has been affected at all by the [challenged] contract[s]"); *Cont'l T.V.*, 433 U.S. at 45 (constraints readily found "reasonable in light of the competitive situation in 'the product market as a whole'") (quoting *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365, 382 (1967)); *Ark. Carpenters Health & Welfare Fund v. Bayer AG*, 604 F.3d 98, 104 (2d Cir. 2010); *Geneva Pharm. Tech. Corp. v. Barr Labs. Inc.*, 386 F.3d 485, 506-07 (2d Cir. 2004).

The district court, however, bypassed the requirement that plaintiffs show an actual adverse effect on competition as a whole, and directly and wrongly shifted the burden to Apple. A2255 ("Apple has not shown that the execution of the Agreements had any pro-competitive effects"). This was error (*Capital Imaging*, 996 F.2d at 547 (defendant's "justifications are unnecessary where … the plaintiff … has not carried its own initial burden of showing a restraint on competition")), particularly here where it is undisputed that Apple, as an entrant, lacked market power (A2041.1492:18-1493:17; *see Capital Imaging*, 996 F.2d at 546). The court had foreshadowed this incorrect presumption in its denial of the motion to dismiss the related class action. *In re Elec. Books*, 859 F. Supp. 2d at 693 ("it is presumed that the conduct by all parties would be unlawful under the rule of reason").

With respect to *price*, plaintiffs' experts focused exclusively on price increases for the *publisher defendants*' e-books (*see*, *e.g.*, A1907¶7; A1908-09¶10; A1922¶45; A1614-21¶¶145-58; *see also* A1891¶21), even though the publishers made up less than half of the relevant market (A1571¶36; A1889-90¶15). Indeed, the bestseller and new release sales (to which the $9.99 price point attached) accounted for only about 10% of the relevant market sales from 2010-2012. A1886¶6; A1892-93¶26; A1178.

The district court pointed to "evidence of [an] across-the-board price increase in e-books sold by the Publisher Defendants and by Random House when it moved to agency." A2256. But Random House was never alleged to be a conspirator and the court in any event did not analyze whether the *relevant market's* pricing was higher than it would have been absent a conspiracy, having erroneously excluded the most probative testimony on this question. A1847:2-6; A2014.1036:1-7; *see infra* pp. 59-62. In fact, average market prices indisputably *went down*, as the data (A2763) and the green line on the following graphic (A1176) show:



Before Apple appeared on the scene in December 2009, the average e-book price in the relevant market was over $8 and higher than it had been a year before. A1176; A2763; A2043.1510:12-1511:7. By December 2010, just 9 months after agency selling commenced, the average price was below $8 and by January 2011, at $7.28, the average price had never been lower, and continued to fall, dropping *below* $7 by December 2011. A1176; A2763; A2044.1515:5-A2045.1516:2. As the court acknowledged, "the prices of e-books generally … decreased on average in the years following the introduction of the iBookstore." A2256 n.61; *see also* A1890-91¶¶18-21; A2042.1506:19-1507:1.

The district court's failure to consider *market-wide* effects was reversible error. A plaintiff cannot meet its burden under the rule of reason to show an actual adverse effect on market-wide competition by focusing on only a subset of e-book publishers or retailers. *See Bookhouse of Stuyvesant Plaza Inc. v. Amazon.com, Inc.*, 2013 WL 6311202, at *5 (S.D.N.Y. Dec. 5, 2013) (section 1 claim failed where plaintiffs "allege[d] harm not to the U.S. e-book market as a whole, but only to the portion of that market that is controlled by plaintiffs' competitor Amazon"); *see also Jefferson Parish*, 466 U.S. at 31 (section 1 is not violated when there is "no showing that the market as a whole has been affected at all by the contract").

With respect to *output*, there was exponential growth in sales of e-books after agency was introduced, both across the relevant market as a whole and with

respect to the publisher defendants' titles. A1893-94¶¶29-30. In addition, the number of e-book *titles* available increased dramatically after Apple's entry. A1894¶32; A1533-34¶¶24-25. Apple's expert demonstrated that after Amazon adopted terms for self-publishers similar to the Apple model (including increasing the royalty rate from 35% to 70% for self-publishers), the number of self-published e-books in the market skyrocketed. A1897¶42. Plaintiffs did not (and could not) rebut this testimony, which is powerful evidence of procompetitive effects. *See Brooke Grp.*, 509 U.S. at 233 ("Supracompetitive pricing entails a restriction in output").

The district court, however, accepted plaintiffs' experts' testimony that the output of four publisher defendants dropped. A2231-32. But this ignores more than half of the relevant market that also adopted agency with Apple, and is consistent with expanding output in the market as a whole. Plaintiffs thus failed as a matter of law to establish that growth in the e-books market slowed after Apple's entry. *See Brooke Grp*, 509 U.S. at 233 (that output allegedly "expanded at a slower rate than it [otherwise] would have" is a "counter-factual proposition" that "is difficult to prove in the best of circumstances").

Finally, even if plaintiffs had proved some actual adverse effects on competition, the overwhelming procompetitive effects of Apple's market entry precluded liability under the rule of reason. *See supra* pp. 8-10, 51-53.[6]

III. The District Court Erred in Excluding Expert Testimony on the Price-Reducing Effects of Apple's Entry into the Market

The district court excluded testimony from Apple's expert, Dr. Michelle Burtis, establishing that the decrease in the average price of e-books in the relevant market "was not the result of any pre-existing downward trend in prices" (A1901¶56), but rather resulted in part from "the entry of Apple and the terms of [its agency] agreements" (A2108.2243:12-16). The court's exclusion of the testimony was deeply prejudicial, as the evidence goes to the core of Apple's challenge to the application of the *per se* rule and plaintiffs' failure of proof under the rule of reason.

Before trial, the district court excluded Dr. Burtis's testimony on the baseless theory that the testimony was not "sufficiently rooted in economic theory

[6] The district court's rule-of-reason analysis recognized the "pro-competitive effects to which Apple has pointed, including its launch of the iBookstore" but found that the iBooks Store's launch was "independent of the Agreements" (A2255), which makes no sense. Without *the agency agreements* there would be no iBooks Store, and that indisputably pro-competitive effect thus directly "flow[s] from the Agreements." A2255.

to be admissible." A1847:2-6; *see also* A2256 n.61.[7] Then, when plaintiffs asked Dr. Burtis at trial whether the increase in output was attributable to agency agreements, Dr. Burtis responded: "I don't know that it's fully attributable, but I definitely think that the entry of Apple and the terms of these agreements provided incentives for those independent publishers to enter the market. And ... as they signed agency agreements and were able to become price setters in the market, stimulated the retail competition that led to decreased prices." A2108.2243:7-16. The government objected that her response was "beyond the scope of this witness'[s] opinion," but the court noted that the question "open[ed] the door." A2108.2243:17-22. However, rather than keep the responsive testimony in the record, the court *sua sponte* invited the government to withdraw the question, which it did. The court then struck the testimony. A2108.2243:22-25. When Dr. Burtis testified on re-direct that Apple's entry and the agency model "intensified competition and led prices to be lower than they otherwise would have been," her opinion was again stricken. A2117.2307:12-24.

[7] The district court's conclusion that this testimony encompassed "new" opinions (A2103.2209:17-A2105.2215:5), is belied by the record (A1887¶8; SEA61-63¶24) and itself reversible error. *See Zerga Ave. Realty Corp. v. Hornbeck Offshore Transp. LLC*, 571 F.3d 206, 213 (2d Cir. 2009) (abuse of discretion to exclude "critical" expert testimony for failure to comply with court order where no prejudice).

The court's exclusion of this critical expert testimony was erroneous. "[A]ll of the analysis" that Dr. Burtis performed was "an attempt to understand … what was driving that black [average price] line [in A1175], and whether or not we could attribute it to the agency agreements or something else." A2110.2261:20-23. In doing so, Dr. Burtis consulted actual market outcomes, which is routine in antitrust analysis. *Brooke Grp.*, 509 U.S. at 233-37; A2297-300 (U.S. Dep't of Justice, Statement by Assistant Attorney General R. Hewitt Pate Regarding the Closing of the Orbitz Investigation (July 31, 2003)). She "analyze[d] ... the factors" driving e-book prices and "collect[ed] the data and the statistics that would allow [her] to figure out" what was causing the decline in prices. A2111.2263:2-7. Dr. Burtis identified explanatory factors showing how the agency agreements stimulated interbrand competition that resulted in lower average e-book prices. *See*, *e.g.*, A1887¶8; A1894¶¶31-32; A1185 (growth of Amazon's catalog accelerated after Apple's entry).

A regression analysis is not mandatory in every economic analysis. *United States v. Valencia*, 600 F.3d 389, 427 (5th Cir. 2010); Dkt247.9; Dkt270.16-18. In fact, plaintiffs' experts performed no such analysis of market pricing. A2040.1490:5-22; A2045.1516:7-1517:14; A2048.1576:13-1577:4; A2111.2263:8-20; A2118.2309:3-6. As Dr. Burtis explained, she controlled for "outside factors" in a manner that allowed her to reach a reliable opinion consistent

with the approach used by plaintiffs' expert, Dr. Gilbert. A2111.2263:21-2264:2; A1886¶5; A1887¶8; A1889-91¶¶13-21. The exclusion of her testimony was therefore an abuse of discretion and reversible error. *See*, *e.g.*, *Gill v. N.Y. City Transit Auth.*, 216 F. App'x 50, 52-53 (2d Cir. 2007); *Baker v. Dalkon Shield Claimants Trust*, 156 F.3d 248, 251 (1st Cir. 1998); *see also Leegin*, 551 U.S. at 884, 907 (reversing where expert testimony regarding procompetitive effects of defendant's pricing policy wrongly excluded).

Even worse, *the court itself solicited testimony from Dr. Gilbert* on the very topic the court barred Dr. Burtis from addressing. As already noted, none of plaintiffs' experts conducted any analysis whatsoever on what would have happened to market prices but for Apple's entry. Yet the court asked Dr. Gilbert "whether the average price would have fallen even more without the alleged conspiratorial activity," to which Dr. Gilbert replied, "yes, … the prices would have fallen even more than they did." A2051.1661:23-A2052.1662:6.[8] This clear double-standard was an abuse of discretion.

[8] Dr. Gilbert simply referenced Dr. Ashenfelter's analysis (A2050.1662:3-6), which, as Dr. Ashenfelter acknowledged, did not purport to analyze whether prices would have fallen further without Apple's entry on agency (A2040.1490:5-22; A2045.1516:7-1517:14; A2118.2309:3-6).

IV. The Injunction Should Be Vacated

The injunction should be vacated along with the district court's decision finding Apple liable under the Sherman Act, because Apple's conduct was not unlawful. In addition, the injunction is unduly punitive, overbroad, and unconstitutional and should be vacated on its own terms.

The injunction required Apple to modify its agreements with the publisher defendants (A2559-61.III) even though those agreements had already been renegotiated and were subject to consent decrees as part of the publishers' settlements. And it regulates Apple's App Store (A2561.IV.B), which is unrelated to either the conduct at issue or the proof at trial. These and other provisions are not "necessary to protect the public from further anticompetitive conduct." *F. Hoffman-La Roche Ltd. v. Empagran S.A.*, 542 U.S. 155, 170 (2004).

The monitorship is legally inappropriate here, with respect to "one of America's most admired, dynamic, and successful technology companies" (A2160), where the alleged conduct related only to "specific events that unfolded in the trade e-book market as 2009 became 2010" (A2292). The publishers' consent decrees did not include a monitor (A1117; A1824; A2388), and the monitorship here smacks as a punishment against Apple for going to trial and appealing, and thus being "unrepentant" (A2375:4-8). A monitorship is not provided for in the Sherman Act's detailed remedial scheme. *See* 15 U.S.C. § 15 *et*

seq. And to the extent the monitor has been afforded investigatory powers, the monitorship violates Federal Rule of Civil Procedure 53 and the constitutional separation of powers. *Cobell v. Norton*, 334 F.3d 1128, 1142 (D.C. Cir. 2003) (monitor's "quasi-inquisitorial, quasi-prosecutorial role" is "unknown to our adversarial legal system" and precluded by the separation of powers).[9]

CONCLUSION

The district court's judgment and injunction should be reversed, and judgment should be entered for Apple. In the alternative, a new trial before a different district judge should be granted. *See United States v. Robin*, 553 F.2d 8, 10 (2d Cir. 1977) (per curiam).

Respectfully submitted this 15th day of July, 2014.

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[9] Apple has separately appealed the district court's denial of its as-applied challenges to the monitorship. Case Nos. 14-60, 14-61; *see also* CA2Dkt131.

CERTIFICATE OF COMPLIANCE

This brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B), the typeface requirement of Fed. R. App. P. 32(a)(5), and the typestyle requirements of Fed. R. App. P. 32(a)(6). This brief contains 13,971 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii), and is prepared in a proportionally spaced typeface (14-point Times New Roman).

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