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# Swiping Through the Pages of Apple’s E-Book Saga: A Comment on Hub-And-Spoke Conspiracies Under the Sherman Act

Travis Clark\*

## I. Introduction

With the release of the iPad in 2009, Apple entered into agreements with five of the six major publishing companies (“publisher defendants” or “publishers”) to sell “e-books” on the new device. At the time, Amazon was the only real competitor in the e-book market. Amazon had set the price of e-books at \$9.99, and the publishing companies saw this pricing as a threat to their way of doing business. Apple approached the publishing companies and proposed an agency model that resulted in the publisher defendants receiving less per e-book sold via Apple as opposed to Amazon. However, this agreement allowed the publishers to regain control of pricing over Amazon. The increase in e-book prices from \$9.99 to \$14.99 (and \$19.99 for best sellers) caught the attention of the United States Department of Justice (“DOJ”), and subsequently, the DOJ and thirty-three states filed suit against Apple and the publisher defendants for conspiring to raise prices across the e-book market.

This Comment will analyze the resulting recent decision *United States v. Apple, Inc.*,<sup>1</sup> and its application of the *per se* rule in determining whether Apple’s conduct unreasonably restrained trade in violation of Section 1 of the Sherman Antitrust Act. Part II will discuss the history and development of Section 1 of the Sherman Act. Part III will provide an overview of *Apple* and the Second Circuit’s decision. Part IV will argue why the rule of reason is the proper standard for

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<sup>1</sup> *United States v. Apple, Inc.*, 791 F.3d 290 (2d Cir. 2015).

analyzing Apple’s liability under § 1 of the Sherman Act. Part V will briefly conclude with why the procompetitive effects outweigh the anticompetitive effects of Apple’s conduct.

## II. History and Development of Section 1

Under Section 1 of the Sherman Antitrust Act (“Sherman Act”), “[e]very contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal.”<sup>2</sup> The 51st Congress passed the Sherman Act in 1890. Although the goals of the Act have been hotly debated since its inception, its core purpose is to protect competition by prohibiting unreasonable restraints of trade.<sup>3</sup> The Sherman Act was constructed broadly in order to adjust to the Nation’s economic conditions as they change over time: “Just as the common law adapts to modern understanding and greater experience, so too does the Sherman Act’s prohibition on ‘restraints of trade’ evolve to meet the dynamics of present economic conditions.”<sup>4</sup>

### A. Setting the Framework

Violation of Section 1 requires proof of “(1) a contract, combination, or conspiracy among two or more separate entities that (2) unreasonably restrains trade and (3) affects interstate or foreign commerce.”<sup>5</sup> A conspiracy requires either direct or circumstantial proof of a concerted action.<sup>6</sup> The Supreme Court has explained that the evidence presented must prove that the parties “had a conscious commitment to a common scheme designed to achieve an unlawful objective.”<sup>7</sup>

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<sup>2</sup> 15 U.S.C. § 1 (year).

<sup>3</sup> See HERBERT HOVENKAMP, THE ANTITRUST ENTERPRISE: PRINCIPLE AND EXECUTION (2005).

<sup>4</sup> *Leegin Creative Leather Prods. v. PSKS, Inc.*, 551 U.S. 877, 899 (2007) (“Congress intended § 1 to give courts the ability ‘to develop governing principles of law’ in the common-law tradition.”) (internal citations omitted); see also *Business Electronics Corp. v. Sharp Electronics Corp.*, 485 U.S. 717, 731 (1988) (“The changing content of the term ‘restraint of trade’ was well recognized at the time the Sherman Act was enacted.”).

<sup>5</sup> Antitrust Law Developments, p. 2.

<sup>6</sup> See *id.*

<sup>7</sup> *Monsanto Co. v. Spray-Rite Service Corp.*, 465 U.S. 752, 768 (1984).

Significantly, this requires more than mere parallel conduct undertaken by competitors.<sup>8</sup> Assuming a conspiracy exists, the next issue is determining the nature or type of restraint that allegedly restricts competition in the relevant market.<sup>9</sup> After the market and the nature of the restraint have been identified, the next issue becomes what standard of analysis applies in determining whether there has been an unreasonable restraint on trade—the rule of reason or the *per se* rule.<sup>10</sup> The rule of reason is the dominant standard for analyzing whether an agreement restrains trade, and it requires courts to balance the restraint’s anticompetitive effects with its procompetitive effects.<sup>11</sup> The *per se* rule is used for restraints with which courts have had enough experience to predict with confidence that the practice would almost always be invalidated under the rule of reason.<sup>12</sup>

#### B. Horizontal and Vertical Price Restraints

This Comment focuses on horizontal and vertical price restraints. Horizontal price restraints exist between two entities at the same level of competition.<sup>13</sup> When two manufacturers produce a similar product, they are competing against each other on the same level of the market.<sup>14</sup> If manufacturer A sells his product at \$10, manufacturer B is incentivized to sell her product at \$9.<sup>15</sup> By lowering the cost of her good, manufacturer B attracts more consumers to purchase her product.<sup>16</sup> However, in order to compete, manufacturer A may lower the price of his good to \$8.<sup>17</sup> When the two manufacturers realize that the competition is harming their ability to turn a profit, it

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<sup>8</sup> *See id.*

<sup>9</sup> *See* State Oil Co. v. Khan, 522 U.S. 1 (1997).

<sup>10</sup> *Leegin Creative Leather Prods. v. PSKS, Inc.*, 551 U.S. 877 (2007).

<sup>11</sup> *Id.* at 885.

<sup>12</sup> *Id.* at 886.

<sup>13</sup> *See* HERBERT HOVENKAMP, THE ANTITRUST ENTERPRISE: PRINCIPLE AND EXECUTION 22–23 (2005).

<sup>14</sup> *See id.*

<sup>15</sup> *See id.*

<sup>16</sup> *See id.*

<sup>17</sup> *See id.*

may be in their best interest to agree on setting the price of their goods at \$10 or even \$11.<sup>18</sup> This is an example of horizontal price fixing.<sup>19</sup>

The Sherman Act is not concerned simply with competitors raising prices to an unreasonable level.<sup>20</sup> In the hypothetical above, if manufacturers A and B decide to fix the price of their good at \$8, their agreement still might be an unlawful restraint of trade—setting maximum prices is as impermissible as setting minimum prices,<sup>21</sup> and it does not matter that the decrease in price is “reasonable.”<sup>22</sup> In 1940, the Supreme Court ruled that price-fixing—regardless of the supposed reasonableness of the price—is a *per se* violation of Section 1 of the Sherman Act.<sup>23</sup> The Court explained that “[u]nder the Sherman Act a combination formed for the purpose and with the effect of raising, depressing, fixing, pegging, or stabilizing the price of a commodity in interstate or foreign commerce is illegal *per se*.”<sup>24</sup> When the convicted group of major oil companies attempted to justify their efforts to stabilize the prices of gasoline in the Midwest, the Court refused to inquire into the reasonableness of their agreements.<sup>25</sup> Instead, the Court concluded that all price-fixing agreements must be “banned because of their actual or potential threat to the central nervous system of the economy.”<sup>26</sup>

Almost forty years later, the Court revisited the issue of whether agreements among competitors to fix prices always falls within a category of activities deemed *per se* unlawful.<sup>27</sup> In

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<sup>18</sup> The optimal price set by such competitors, assuming no other competitors, will depend on the costs of production and the elasticity of consumer demand. See ANDREW I. GAVIL ET AL., *ANTITRUST LAW IN PERSPECTIVE: CASES, CONCEPTS AND PROBLEMS IN COMPETITION POLICY* 18–21 (2d ed. 2008).

<sup>19</sup> See HOVENKAMP, *supra* note 13.

<sup>20</sup> See *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150 (1940).

<sup>21</sup> *Id.*

<sup>22</sup> *Id.*

<sup>23</sup> *Id.*

<sup>24</sup> *Id.* at 223–24.

<sup>25</sup> *Id.* at 220–21.

<sup>26</sup> *Socony-Vacuum Oil Co.*, 310 U.S. at 224–25 n. 59.

<sup>27</sup> *Broadcast Music, Inc. v. Columbia Broadcasting Sys., Inc.*, 441 U.S. 1 (1979).

*Broadcast Music, Inc. v. Columbia Broadcasting System, Inc.*, the Court ruled that, while horizontal price-fixing is inherently anticompetitive, “it is only after considerable experience with certain business relationships that courts [can] classify” certain arrangements as *per se* violations.<sup>28</sup> At issue was whether the use of blanket licenses by ASCAP and BMI to CBS of blanket licenses to copyrighted music was *per se* unlawful price fixing. The Court found that the blanket licenses involved “price fixing” in the literal sense, but stated that: “We have never examined a practice like this one before. And though there has been rather intensive antitrust scrutiny of ASCAP and its blanket licenses, that experience hardly counsels that we should outlaw the blanket license as a *per se* restraint of trade.”<sup>29</sup> Thus, “price fixing” is *per se* illegal but conduct that might literally be so described is not necessarily categorized as such. In making the categorization decision, the Court uses analysis similar to the rule of reason to determine the appropriate analysis.<sup>30</sup> While horizontal agreements to fix prices are almost always *per se* illegal, courts must have considerable experience with the relevant business relationships before categorizing the restraint as a *per se* violation of the Sherman Act.<sup>31</sup>

Vertical price restraints, by contrast, exist between two entities on different levels of competition.<sup>32</sup> When manufacturer A agrees with retailer X that X will not sell his product under \$10, they have engaged in vertical price fixing.<sup>33</sup> These types of agreements are called “resale price maintenance” agreements (“RPMs”).<sup>34</sup> For over a century, vertical price fixing was *per se* illegal.<sup>35</sup> However, in 2007, the Supreme Court acknowledged that RPMs can have both

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<sup>28</sup> *Id.* at 9–10.

<sup>29</sup> *Id.*

<sup>30</sup> *See id.*

<sup>31</sup> *Id.*

<sup>32</sup> *See* HOVENKAMP, *supra* note 13, 24–25.

<sup>33</sup> *Id.*

<sup>34</sup> *Leegin*, 551 U.S. at 886–87.

<sup>35</sup> *Id.* at 899 (overturning *Dr. Miles*).

anticompetitive and procompetitive effects on competition.<sup>36</sup> For example, powerful retailers may abuse RPMs to encourage a manufacturer to boycott a rival retailer, which in effect may reduce output—an anticompetitive effect.<sup>37</sup> Conversely, RPMs “can increase interbrand competition by facilitating market entry for new firms and brands”—a procompetitive effect.<sup>38</sup> For this and other procompetitive reasons, vertical price restraints are now reviewed under the rule of reason.<sup>39</sup>

The rule of reason is the dominant analysis in most antitrust claims because whether or not a questioned agreement imposes an unreasonable restraint on competition depends on a case-by-case analysis balancing the anticompetitive and procompetitive effects.<sup>40</sup> Under the rule of reason, courts look at information peculiar to the relevant business, as well as the restraint’s nature, purpose, and effect to determine its reasonableness.<sup>41</sup>

Some courts have established a third standard of analysis known as the “quick look” rule. This type of review is an abbreviated version of the rule of reason when the anticompetitive effects are easily ascertained.<sup>42</sup> Essentially it shifts the burden of proof from the plaintiff—to provide a

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<sup>36</sup> *Id.* at 892.

<sup>37</sup> *See id.*; *see also id.* at 893–94 (“Resale price maintenance, furthermore, can be abused by a powerful manufacturer or retailer. A dominant retailer, for example, might request resale price maintenance to forestall innovation in distribution that decreases cost. A manufacturer might consider it has little choice but to accommodate the retailer’s demands for vertical price restraints if the manufacturer believes it needs access to the retailer’s distribution network. A manufacturer with market power, by comparison, might use resale price maintenance to give retailers an incentive not to sell the products if smaller rivals or new entrants. As should be evident, the potential anticompetitive consequences of vertical price restraints must not be ignored or underestimated . . . . Notwithstanding the risks of unlawful conduct, it cannot be stated with any degree of confidence that resale price maintenance always or almost always tend to restrict competition and decrease output.”) (internal citations omitted).

<sup>38</sup> *See id.* at 891–94. (“Resale price maintenance, in addition, can increase interbrand competition by facilitating market entry for new firms and brands. New manufacturers and manufacturers entering new markets can use the restrictions in order to induce competent and aggressive retailers to make the kind of investment of capital and labor that is often required in the distribution of products unknown to the consumer . . . . New products and new brands are essential to a dynamic economy, and if markets can be penetrated by using resale price maintenance there is a precompetitive effect.”) (internal citations omitted).

<sup>40</sup> *See* *Cont’l T.V. v. GTE Sylvania*, 433 U.S. 36, 49–50 (1977). However, this is not true for some kinds of horizontal agreements, paradigmatically agreements to fix prices or to divide markets. *See Leegin*, 551 U.S. at 886.

<sup>41</sup> *Leegin*, 551 U.S. at 885.

<sup>42</sup> *United States v. Apple, Inc.*, 791 F.3d 290, 330 (2d Cir. 2015).

full market analysis—to the defendant—to present the procompetitive justifications for its conduct.<sup>43</sup>

### C. The Steady Retreat of *Per Se* Liability

In *Leegin*, the Supreme Court overturned the *Dr. Miles*<sup>44</sup> precedent, and in doing so, explained how the *per se* rule under Section 1 has narrowed: “[R]espected authorities in the economics literature suggest the *per se* rule is inappropriate, and there is now widespread agreement that resale price maintenance can have procompetitive effects.”<sup>45</sup> The Court relied on Congress’s failure to set *Dr. Miles* in stone evidenced the need for antitrust principles to ““evol[ve] with new circumstances and new wisdom.””<sup>46</sup>

The Court’s retreat from the *per se* rule for vertical conduct began in 1977, when the Court overturned the *per se* rule for vertical non-price restraints and adopted the rule of reason in its stead.<sup>47</sup> In the 1980s, the Court further narrowed the scope of the *per se* rule when it held that vertical agreements to terminate a price-cutting competitor was to be analyzed under the rule of reason.<sup>48</sup> In 1997, the Court overruled a twenty-nine year-old precedent treating vertical maximum price-fixing agreements as *per se* illegal.<sup>49</sup> And finally in 2007, the Court abolished the *per se* treatment of vertical minimum price-fixing agreements—thus, requiring the application of the rule of reason to *all* vertical conduct.<sup>50</sup> The Court stated:

In sum, it is a flawed antitrust doctrine that serves the interests of lawyers—by creating legal distinctions that operate as traps for the unwary—more than the interests of

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<sup>43</sup> *See id.*

<sup>44</sup> *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911).

<sup>45</sup> *Leegin*, 551 U.S. at 900.

<sup>46</sup> *Id.* at 905 (citing *Business Electronics*, 485 U.S. at 732).

<sup>47</sup> *See Cont’l T.V. v. GTE Sylvania*, 433 U.S. 36 (1977) (overruling *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365 (1967)).

<sup>48</sup> *Leegin*, 551 U.S. at 901 (citing *Business Electronics*, 485 U.S. at 726–727, 735–736).

<sup>49</sup> *State Oil Co. v. Khan*, 522 U.S. 3, 22 (1997).

<sup>50</sup> *Leegin*, 551 U.S. at 901.



consumers—by requiring manufacturers to choose second-best options to achieve sound business objectives.<sup>51</sup>

Even with the steady retreat of the *per se* rule, determining how to analyze a restraint of trade is far from simple since arrangements usually involve a combination of various horizontal and vertical agreements.<sup>52</sup> Group boycotts and “hub-and-spoke” arrangements are two categories that blur the lines between horizontal and vertical conduct.

#### D. Group Boycotts

Group boycotts occur when a prominent firm fosters an agreement with and among competing firms in order to cease dealing with, or boycott, a rival retailer or manufacturer.<sup>53</sup> Horizontal agreements between competitors to boycott a rival firm are said to be *per se* violations of Section 1 of the Sherman Act.<sup>54</sup> Assuming the underlying concerted action has been found, a court must determine if that action unreasonably restricted competition.<sup>55</sup> Since the Court has had significant experience with group boycotts, identifying certain types of reoccurring characteristics allows lower courts to find this practice a *per se* violation of the Sherman Act.<sup>56</sup>

However, the antitrust treatment of such arrangements is not very straightforward.<sup>57</sup> In *Northwest Wholesale Stationers, Inc. v. Pacific Stationery and Printing Co.*,<sup>58</sup> the Supreme Court noted that, even though group boycotts are often subject to *per se* invalidation, “exactly what types of activity fall within the forbidden category is . . . far from certain.”<sup>59</sup> Northwest Wholesale

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<sup>51</sup> *Id.* at 903 (“For these reasons the Court’s decision in *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911), is now overruled. Vertical price restraints are to be judged according to the rule of reason.”).

<sup>52</sup> Antitrust Law Development, p. 21–22.

<sup>53</sup> *Klor’s, Inc. v. Broadway-Hale Stores, Inc.*, 359 U.S. 207 (1959).

<sup>54</sup> *Northwest Wholesale Stationers, Inc. v. Pacific Stationery and Printing Co.*, 472 U.S. 284, 294–95 (1985).

<sup>55</sup> See GAVIL ET AL., *supra* note 13, at 138–44.

<sup>56</sup> See Antitrust Handbook § 2:19 p. 287–88.

<sup>57</sup> See *Northwest Wholesale Stationers*, 472 U.S. 284.

<sup>58</sup> *Id.*

<sup>59</sup> *Id.* at 293–94.

Stationers (“Northwest”) was a purchasing cooperative made up of a group of office supply retailers that decided to expel one of its members (“Pacific”).<sup>60</sup> Pacific alleged that Northwest’s expulsion of them from the cooperative was a group boycott and thus, a *per se* violation of the Sherman Act.<sup>61</sup> Although the Court found that Northwest’s conduct was a group boycott in restraint of trade, the Court ruled that, absent a showing that a group boycott possesses sufficient market power, courts should defer to a rule of reason analysis.<sup>62</sup>

#### E. Hub-and-Spoke Conspiracies

“Hub-and-spoke” conspiracies have been analyzed in a similar manner. “A traditional hub-and-spoke conspiracy has three elements: (1) a hub, such as a dominant purchaser; (2) spokes, such as competing manufacturers or distributors that enter into vertical agreements with the hub; and (3) the rim of the wheel, which consists of horizontal agreements among the spokes.”<sup>63</sup> Cases involving “hub-and-spoke” arrangements either consist of the “hub” dominant retailer shepherding a group of horizontal competitors to boycott a rival of the retailer, or a group of horizontal competitors enlisting a “hub” supplier to enforce their collusive boycotting of one of their rivals.<sup>64</sup> “Hub-and-spoke” conspiracies are difficult to prove because most courts require proof of a “rim”—that is, a conspiracy among horizontal competitors—before holding the “hub” liable for its conduct.<sup>65</sup>

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<sup>60</sup> *Id.*

<sup>61</sup> *Id.*

<sup>62</sup> *Northwest Wholesaler Stationers*, 472 U.S. 284. The Court identified common questions for determining if the *per se* standard applies: (1) is the group action directed at fixing or restraining price competition; (2) is the claimed boycott horizontal or vertical in nature; (3) does it cut competitors off from access to a key resource; (4) do the boycotting parties have sufficient market power for their actions to be of competitive concern; and (5) have the defendants presented a plausible procompetitive justification for their conduct? A reoccurring issue within the group boycott framework is whether proof of market power is necessary, and if so, how much? *See id.*

<sup>63</sup> *In re Musical Instruments & Equip. Antitrust Litig.*, 798 F.3d 1186 (9th Cir. 2015).

<sup>64</sup> Brief for Petitioner at 26–27, *Apple, Inc. v. United States*, No. 15-565 (U.S. Dec. 2, 2015).

<sup>65</sup> *In re Musical Instruments*, 798 F.3d at 1192 n.3.

The leading case on hub-and-spoke conspiracies is *Toys “R” Us, Inc. v. F.T.C.*,<sup>66</sup> in which the dominant retailer (“Toys “R” Us) orchestrated a manufacturer boycott of discount warehouse clubs competing with it.<sup>67</sup> While the boycotting manufacturers accounted for over forty percent of total industry sales, Toys “R” Us was a dominant entity at the affected retailer level.<sup>68</sup> The court held that Toys “R” Us facilitated a *per se* illegal group boycott by using its dominant market power to cut off the boycotted firm’s access to the manufacturers without any plausible justification for enhancing competition.<sup>69</sup>

While not all courts have recognized the existence of “hub-and-spoke” arrangements, most have recognized the general idea behind them.<sup>70</sup> The “hub-and-spoke” inquiry was developed prior to *Leegin*<sup>71</sup> when distinguishing vertical and horizontal price-fixing was irrelevant because both were deemed *per se* illegal.<sup>72</sup> Essentially, as long as the restraint was meant to fix prices and the vertical actor was found to have facilitated the horizontal cartel, the “hub-and-spoke” conspiracy was *per se* illegal. However, *Leegin*’s holding presents a new dilemma for analyzing “hub-and-spoke” arrangements.<sup>73</sup> Significantly, in dicta, the Supreme Court stated that:

A horizontal cartel among competing manufacturers or competing retailers that decreases output or reduces competition in order to increase price is, and ought to be, *per se* unlawful. To the extent a vertical agreement setting minimum resale prices is entered upon to facilitate either type of cartel, it, too, would need to be held unlawful under the rule of reason.<sup>74</sup>

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<sup>66</sup> 221 F.3d 928 (7th Cir. 2000).

<sup>67</sup> *See id.*

<sup>68</sup> *Id.*

<sup>69</sup> *See Toys “R” Us, Inc. v. F.T.C.*, 221 F.3d 928 (7th Cir. 2000).

<sup>70</sup> *In re Musical Instruments*, 798 F.3d at 1186.

<sup>71</sup> 551 U.S. 877.

<sup>72</sup> *See id.*

<sup>73</sup> *Apple*, 791 F.3d at 346 (Jacobs, J., dissenting).

<sup>74</sup> *Leegin*, 551 U.S. at 893.

Since “hub-and-spoke” conspiracies include both vertical and horizontal actors, it is necessary to clarify whether the *per se* rule or the rule of reason analysis applies. Put differently, should the vertical “hub’s” conduct be reviewed under the *per se* rule or the rule of reason?<sup>75</sup> The remainder of this Comment will focus on answering this question by analyzing the e-book saga.<sup>76</sup>

### III. United States v. Apple

#### A. E-Book Background

In 2007, the page was turned on the book industry when Amazon released the Kindle, an electronic reading device that allows consumers to purchase, download, and read e-books.<sup>77</sup> Prior to its development, the paper-book industry operated under a fairly stable business model.<sup>78</sup> A publisher would sell the hardcover copies of a new release to a retailer at a “wholesale” price.<sup>79</sup> The publisher would then recommend a “list” price for resale to the consumer.<sup>80</sup> In the United States, the six largest publishers “stood at the center of the multi-billion dollar book-producing industry.”<sup>81</sup> Hachette, HarperCollins, Macmillan, Penguin, Random House, and Simon & Schuster are known as the “Big Six” in the publishing industry.<sup>82</sup> In 2010, the “Big Six” published

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<sup>75</sup> The answer I reach is that the rule of reason applies to the “hub” of such conspiracy. I am mindful, however, of the quick look approach which would allow the burden to shift to the “hub” to state the procompetitive justifications if a horizontal cartel has already been proven. As the Sixth Circuit stated, “[c]ourts cannot act perfunctorily when distinguishing restraints that merit a *per se* approach from those that deserve rule of reason analysis, and only if a restraint clearly and unquestionably falls within one of the handful of categories that have been collectively deemed *per se* anticompetitive can a court be justified in failing to apply an appropriate economic analysis to make this determination.” *Expert Masonry, Inc. v. Boone Cty, Ky.*, 440 F.3d 336, 343–44 (6th Cir. 2006).

<sup>76</sup> “E-book saga” refers to *United States v. Apple, Inc.*, 791 F.3d 290 (2d Cir. 2015).

<sup>77</sup> *United States v. Apple, Inc.*, 791 F.3d 290, 296 (2d Cir. 2015).

<sup>78</sup> *Id.* at 298.

<sup>79</sup> *Id.*

<sup>80</sup> *Id.*

<sup>81</sup> *Id.*

<sup>82</sup> *See Apple*, 791 F.3d at 298. Only five of the six publishers accepted Apple’s terms and were a party to this lawsuit. *Id.* Those five will be referenced to as the “publisher defendants” throughout this Comment.

ninety-percent of the *New York Times* bestsellers in the United States.<sup>83</sup> As the Second Circuit noted, under this business model, the publishers never really competed with one another on price.<sup>84</sup>

Amazon dominated the e-book market until Apple’s launch of the iPad and the iBookstore on January 27, 2010.<sup>85</sup> Before Apple’s entry into the e-book market, Amazon claimed almost ninety-percent of the e-book retail market and essentially faced no competition.<sup>86</sup> Under a “loss leader” business plan, Amazon sold its new releases and best-seller e-books for \$9.99—a lower price than the wholesale prices the publishers charged Amazon.<sup>87</sup> This pricing strategy assured Amazon’s domination of the e-book market and attracted consumers to its other products.<sup>88</sup> It also discouraged potential competitors from entering the market “because an entrant ‘would run the risk of losing money’” if it attempted to offer readers new innovative e-book platforms.<sup>89</sup>

Amazon’s pricing not only hurt competition, but it also threatened the publishers who had no choice but to accept Amazon’s loss-leading retail model.<sup>90</sup> The publishers believed the below-cost e-book pricing was “predatory” because it “cannibalized” sales of hardcover print books.<sup>91</sup> However, the publishers, acting independently, were powerless against Amazon—which occasionally threatened publishers with retaliatory practices such as “remov[ing] the ‘buy buttons’ for print and e-book versions” of certain titles.<sup>92</sup> The publishers had one potential option to withhold e-books from Amazon—“windowing.”<sup>93</sup> But there were significant costs to windowing;

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<sup>83</sup> *Id.*

<sup>84</sup> See Geoffrey Manne, *Why I Think the Apple E-books Antitrust Decision Will (or At Least Should) Be Overturned*, TRUTHONTHEMARKET (July 22, 2013) (“The price of Stephen King’s latest novel likely has, at best, a trivial effect on sales of... nearly every other fiction book published, and probably zero effect on sales of non-fiction books.”).

<sup>85</sup> *Apple*, 791 F.3d at 308.

<sup>86</sup> *Id.* at 342 (Jacobs, J., dissenting).

<sup>87</sup> *Id.*

<sup>88</sup> *Id.*

<sup>89</sup> *Id.*

<sup>90</sup> *Apple*, 791 F.3d at 342.

<sup>91</sup> *Id.*

<sup>92</sup> *Id.* at 343 (Jacobs, J., dissenting) (referring to Macmillan).

<sup>93</sup> See *United States v. Apple Inc.*, 952 F. Supp. 2d 638, 651–52 (S.D.N.Y. 2013) (“By making the more expensive hardcover version available to the public before the lower priced e-book, the publisher defendants hoped to protect

“it made books unavailable to consumers in digital form, alienated e-book readers, encouraged piracy, and harmed long-term book sales.”<sup>94</sup> The publishers were motivated to regain some pricing power and find a new entrant to challenge Amazon’s monopoly. Enter Apple—“marketplace vigilante.”<sup>95</sup>

In December 2009, after developing the iBookstore for the iPad’s launch, Apple opened negotiations with each of the Big Six.<sup>96</sup> Concerned with competing effectively with Amazon, Apple focused on finding a way to enter the e-book market on profitable terms.<sup>97</sup> Apple understood two things: (1) the publishers were unhappy with what they viewed as Amazon’s predatory pricing; and (2) to break Amazon’s barrier to entry, Apple needed to attract “a critical mass of publishers so that it could provide a broad, compelling-book selection to consumers.”<sup>98</sup>

With the iPad launch only weeks away, Apple devised a vertical distribution contract with three core components: an agency system, a “most-favored-nation” (“MFN”) clause, and a maximum price cap.<sup>99</sup> The agency model, in contrast to Amazon’s wholesale model, allowed the publishers to “set the retail prices of e-books sold through Apple’s platform,” while allowing Apple to take a fixed commission on each sale.<sup>100</sup> But the agency model exposed Apple to a big risk—it allowed for the publishers to potentially set prices un-competitively high.<sup>101</sup> As a solution, Apple used MFN clauses to ensure that each publisher did not set prices higher than those offered by any other e-book retailer.<sup>102</sup> Additionally, Apple used price caps to ensure “that a publisher would not

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the sales of New Release hardcover books and to pressure Amazon to raise its e-book prices.”).

<sup>94</sup> Brief for Petitioner at 5, *Apple, Inc. v. United States*, No. 15-565 (U.S. Dec. 2, 2015); *see also* *Apple*, 952 F. Supp. 2d at 653.

<sup>95</sup> *Apple*, 791 F.3d at 298.

<sup>96</sup> *Id.*

<sup>97</sup> *Id.* at 343 (Jacobs, J., dissenting).

<sup>98</sup> Brief for Petitioner at 7, *Apple, Inc. v. United States*, No. 15-565 (U.S. Dec. 2, 2015).

<sup>99</sup> *Apple*, 791 F.3d at 343 (Jacobs, J., dissenting).

<sup>100</sup> *Id.*

<sup>101</sup> *Id.*

<sup>102</sup> *Id.*

set its iBookstore prices so high to damage . . . [its] credibility with consumers.”<sup>103</sup> These interrelated provisions made it possible for Apple to enter the e-books market as a viable competitor against Amazon.<sup>104</sup>

After intense negotiations with each of the Big Six, five publishers signed Apple’s agency contract.<sup>105</sup> “Apple unveiled its e-book retail platform—the iBookstore—at the first public demonstration of the iPad on January 27, 2010.”<sup>106</sup> The publishers then acted in concert to negotiate new terms with Amazon.<sup>107</sup> The MFN clauses in Apple’s contracts with the publishers essentially forced the publishers to convince Amazon to adopt an agency model.<sup>108</sup> If Amazon had continued to sell e-books at below-cost prices, “the MFN clause would [have] allowed Apple to match Amazon’s price for bestsellers, and pay the publishers no more than a percentage commission on \$9.99.”<sup>109</sup> The publishers, encouraged by an Apple executive, acted as a “united front”<sup>110</sup> and by June 2010, each publisher had convinced Amazon to adopt an agency model.<sup>111</sup> Apple’s entry was disruptive to say the least.<sup>112</sup> Within two years, Amazon’s share of the e-book

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<sup>103</sup> Brief for Petitioner at 8, *Apple, Inc. v. United States*, No. 15-565 (U.S. Dec. 2, 2015).

<sup>104</sup> *See id.* Compare to the majority opinion in *Apple*: “Thus, the terms of the negotiation between Apple and the publishers became clear: Apple wanted quick and successful entry into the e-book market and to eliminate retail price competition with Amazon. In exchange, it offered the publishers an opportunity ‘to confront Amazon as one of an organized group . . . united in an effort to eradicate the \$9.99 price point.’ Both sides needed a critical mass of publishers to achieve their goals. The MFN played a pivotal role in this *quid pro quo* by ‘stiffen[ing] the spines of the [publishers] to ensure that they would demand new terms from Amazon,’ and protecting Apple from retail price competition.” *Apple*, 791 F.3d at 305. However, the majority erred in two ways: (1) by demonizing Apple’s independent business interest in wanting a “quick and successful entry into the e-book market;” and (2) by suggesting that there was any retail price competition to begin with. Significantly, long-term prices have fallen as a whole since Apple’s market entry. *See id.*

<sup>105</sup> *Id.* at 343 (Jacobs, J., dissenting) (noting that “[o]nly Random House, the country’s largest publisher, did not” sign; the five signatures represented over forty-eight percent of all e-books in the United States).

<sup>106</sup> *Id.*

<sup>107</sup> *Id.*

<sup>108</sup> *Id.*

<sup>109</sup> *Apple*, 791 at 343–44 (Jacobs, J., dissenting).

<sup>110</sup> *Id.* at 344.

<sup>111</sup> Brief for Petitioner at 10, *Apple, Inc. v. United States*, No. 15-565 (U.S. Dec. 2, 2015).

<sup>112</sup> *Apple*, 791 F.3d at 342 (Jacobs, J., dissenting) (characterizing as “a substantial monopoly” a market share of “over 80% of the field”). Prior to Apple’s disruptive entry, “Amazon’s ninety-percent market share constituted a monopoly under antitrust law.” *Id.*

retail market dropped from ninety-percent to *sixty percent*, total e-book *output increased*, and overall e-book *prices fell*.<sup>113</sup>

## B. The Second Circuit’s Discussion

Judge Debra Anne Livingston wrote the majority opinion for the Second Circuit in *Apple*<sup>114</sup> and held that Apple’s facilitation of the publisher defendants’ horizontal conspiracy was a *per se* violation of the Sherman Act.<sup>115</sup> Alternatively, Judge Livingston affirmed the district court’s opinion under the rule of reason.<sup>116</sup> Judge Raymond Lohier joined Judge Livingston in the majority opinion (“the majority”), but wrote a separate concurring opinion explaining why he felt the *per se* standard applied and no further rule of reason inquiry was necessary.<sup>117</sup> Judge Jacobs dissented, finding that Apple had not violated the Sherman Act because Apple’s procompetitive justifications outweighed its anticompetitive conduct when the appropriate rule of reason analysis was applied to Apple’s conduct as a vertical facilitator of a horizontal conspiracy.<sup>118</sup> However, the Second Circuit panel did not reach a majority on the rule of reason analysis.<sup>119</sup> Rather, the majority affirmed the district court’s ruling and held that Apple conspired with the publisher defendants to eliminate retail price competition and to raise e-book prices in violation of Section 1 of the Sherman Act.<sup>120</sup>

The majority began its analysis by concluding that there was enough direct and circumstantial evidence to conclude that the provisions in Apple’s contracts with the publishers,

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<sup>113</sup> *Id.* at 328 (noting that prices across the e-book market as a whole fell slightly and total output increased).

<sup>114</sup> *Apple*, 791 F.3d 290.

<sup>115</sup> *See id.* (“In light of our conclusion that the district court did not err in determining that Apple organized a price-fixing conspiracy among the publisher defendants, Apple and the dissent’s initial argument against the *per se* rule—that Apple’s conduct must be subject to rule-of-reason analysis because it involved merely multiple independent, vertical agreements with the publisher defendants—cannot succeed”).

<sup>116</sup> *Id.* at 329.

<sup>117</sup> *Id.*

<sup>118</sup> *Id.* at 342 (Jacobs, J., dissenting).

<sup>119</sup> *Id.* at 349 (Jacobs, J. dissenting).

<sup>120</sup> *Apple*, 791 F.3d at 325.



although each independently lawful, showed that Apple “consciously orchestrated a conspiracy among the publisher defendants.”<sup>121</sup> After finding that Apple’s vertical conduct facilitated the publisher defendant’s horizontal price-fixing conspiracy, the majority concluded that “the relevant agreement in restraint of trade” was the horizontal price-fixing conspiracy, “not Apple’s vertical contracts with the publisher defendants.”<sup>122</sup>

Judge Livingston primarily relied on two Supreme Court cases, *Klor’s Inc. v. Broadway-Hale Stores, Inc.*<sup>123</sup> and *United States v. General Motors Corp.*,<sup>124</sup> to show that all participants in a “hub-and-spoke” conspiracy are liable “when the objective of the conspiracy [is] a *per se* unreasonable restraint of trade.”<sup>125</sup> The majority concluded that the wording in *Leegin*<sup>126</sup> did not change the law governing “hub-and-spoke” conspiracies because the passage was “entirely consistent with holding the ‘hub’ liable for the horizontal agreement that it joins.”<sup>127</sup> The majority reasoned that, in “hub-and-spoke” arrangements, “the vertical organizer has not only committed to vertical agreements, but has also agreed to participate in the horizontal conspiracy.”<sup>128</sup> In sum, the court held that Apple, as the vertical organizer of a horizontal conspiracy, agreed to a price-fixing restraint that was not “any less anticompetitive than its co-conspirators, and [therefore could not] escape *per se* liability.”<sup>129</sup> In the alternative, Apple argued that it ought to be allowed to introduce its procompetitive justifications for facilitating the horizontal conspiracy because the arrangement promoted “enterprise and productivity.”<sup>130</sup> However, the majority did not believe

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<sup>121</sup> *Id.* at 317.

<sup>122</sup> *Id.* at 323.

<sup>123</sup> *Klor’s, Inc. v. Broadway-Hale Stores, Inc.*, 359 U.S. 207 (1959).

<sup>124</sup> *United States v. Gen. Motors Corp.*, 384 U.S. 127 (1966).

<sup>125</sup> *Apple*, 791 F.3d at 322.

<sup>126</sup> 551 U.S. 887.

<sup>127</sup> *Apple*, 791 U.S. at 324.

<sup>128</sup> *Id.* at 325.

<sup>129</sup> *Id.*

<sup>130</sup> *See Broadcast Music, Inc.*, 441 U.S. at 1.

that Apple’s emergence into the e-book industry fit within the narrow line of decisions supporting its argument.<sup>131</sup>

Judge Livingston, writing for herself, continued to analyze the competitive effect of Apple’s horizontal agreement with the publisher defendants under the rule of reason.<sup>132</sup> She stated: “I am mindful of Apple’s argument that the nascent e-book industry has some new and unusual features and that the *per se* rule is not fit for ‘business relationships where the economic impact of certain practices is not immediately obvious.’”<sup>133</sup> However, Judge Livingston applied an abbreviated version of the rule of reason—known as a “quick look” rule.<sup>134</sup> She felt the “quick look” analysis was appropriate given that the anticompetitive effects of Apple’s conduct were easily ascertained.<sup>135</sup> Thus, the burden of proof shifted directly to Apple’s procompetitive justifications for organizing the conspiracy.<sup>136</sup>

First, Judge Livingston dismissed Apple’s argument that “by eliminating Amazon’s \$9.99 price point, the agreement enabled Apple and other e-book retailers to enter the market and challenge Amazon’s dominance.”<sup>137</sup> She reasoned that Apple’s deconcentration of the e-book industry was no justification for eliminating retail price competition.<sup>138</sup> Further, she concluded that “Apple and the dissent err[ed] first in equating a symptom (a single-retailer market) with a disease (a lack of competition), and then err[ed] again by prescribing the disease itself as the cure.”<sup>139</sup>

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<sup>131</sup> See *id.*; see also *Nat’l Collegiate Athletic Ass’n v. Bd. of Regents*, 468 U.S. 85 (U.S. 1984).

<sup>132</sup> *Apple*, 791 U.S. at 329.

<sup>133</sup> *Id.* at 329 (citing *Leegin*, 551 U.S. 877).

<sup>134</sup> *Id.* at 330.

<sup>135</sup> See *id.* The quick look rule might be appropriate, but the use of it here tainted the rule of reason analysis and was written merely in response to the dissent.

<sup>136</sup> *Id.*

<sup>137</sup> *Apple*, 791 F.3d at 330.

<sup>138</sup> *Id.* at 331.

<sup>139</sup> *Id.* at 332.

Second, Judge Livingston dismissed Apple’s argument that the eventual industry-wide decline of e-book prices was a procompetitive benefit because “Apple failed to establish a connection between the benefits and the conspiracy among Apple and the publisher defendants.”<sup>140</sup> In addition, she dismissed Apple’s argument that the technological innovations embedded in the iPad were procompetitive benefits to consumer since the iPad was unrelated to Apple’s agreement with the publisher defendants.<sup>141</sup> In sum, Judge Livingston found that Apple failed to present any viable procompetitive justifications for facilitating a horizontal price-fixing conspiracy and the abbreviated rule of reason analysis was simply offered in response to the dissenting opinion.<sup>142</sup>

In contrast, Judge Jacob, in his dissenting opinion, concluded that Apple’s procompetitive justifications outweighed its anticompetitive conduct when the appropriate rule of reason analysis was applied to Apple’s role as a vertical facilitator of a horizontal conspiracy.<sup>143</sup> Judge Jacobs focused on three points to illustrate the majority’s and the district court’s errors: (1) that a “vertical agreement designed to facilitate a horizontal cartel ‘would need to be held unlawful *under the rule of reason*’”; (2) that “the district court’s alternative ruling under the rule of reason was predetermined by its (erroneous) *per se* ruling”; and (3) that “Apple’s conduct, assessed under the rule of reason on the horizontal plane of retail competition, was unambiguously and overwhelmingly pro-competitive.”<sup>144</sup>

Judge Jacobs began with the reminder that *per se* liability is the exception and “is reserved for those categories of behavior so definitely and universally anticompetitive that a court’s consideration of market force and reasonableness would be pointless.”<sup>145</sup> He then relied on the

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<sup>140</sup> *Id.* at 334.

<sup>141</sup> *Id.* at 335.

<sup>142</sup> *Id.*

<sup>143</sup> *Apple*, 791 F.3d at 348 (Jacobs, J., dissenting).

<sup>144</sup> *Id.* at 341.

<sup>145</sup> *Id.* at 345.

Supreme Court’s steady retreat from the *per se* rule and its explicit signal from *Leegin*<sup>146</sup> to conclude that the vertical participant in a “hub-and-spoke” conspiracy can no longer be held a *per se* violation of the Sherman Act.<sup>147</sup>

In his reasoning, Judge Jacobs focused on the competitive differences between horizontal collusion and the influence of a vertical arrangement on a horizontal cartel.<sup>148</sup> He pointed out that “[c]ollusion among competitors does not describe Apple’s conduct or account for its motive.”<sup>149</sup> Rather, Apple’s competition with Amazon (the dominant retailer) took place on a “horizontal plane distinct from the plane of the horizontal conspiracy among the publishers.”<sup>150</sup> Significantly, Judge Jacobs stated “[a]ll Apple’s energy—all it did that has been condemned in this case—was directed to weakening its competitive rival, and pushing it aside to make room for Apple’s entry.”<sup>151</sup>

Additionally, Judge Jacobs concluded that the *per se* rule was inapplicable because several features made the restraint one that no court had previously considered: “(a) a vertical relationship (b) facilitating a horizontal conspiracy (c) to overcome barriers to entry in a market dominated by a single firm (d) in an industry created by an emergent technology.”<sup>152</sup>

Under a full rule of reason analysis, Judge Jacobs reached the conclusion that Apple’s conduct yielded “such substantial procompetitive results that *per se* liability [was] an abdication of the duty to distinguish reasonable restraints from those that are unreasonable.”<sup>153</sup> First, Judge Jacobs accounted for the anticompetitive effects of Apple’s conduct: shifting the pricing power

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<sup>146</sup> 551 U.S. 877.

<sup>147</sup> *Apple*, 791 U.S. at 346 (Jacobs, J., dissenting).

<sup>148</sup> *Id.*

<sup>149</sup> *Id.* at 347.

<sup>150</sup> *Id.*

<sup>151</sup> *Id.* at 347–48 (Jacobs, J., dissenting).

<sup>152</sup> *Id.* at 348.

<sup>153</sup> *Apple*, 791 F.3d at 348 (Jacobs, J., dissenting).

from e-book retailers to e-book publishers<sup>154</sup> and “end[ing] Amazon’s \$9.99 price for most new releases and bestsellers.”<sup>155</sup> Next, he turned to the procompetitive effects: deconcentrating the e-book retail market, removing barriers to entry by others, and encouraging innovation.<sup>156</sup> Further, the dissent argued that the absence of an appropriate alternative theory for Apple’s market entry “bespeaks the reasonableness of the measures Apple took.”<sup>157</sup> Judge Jacobs concluded with the following statement:

Apple took steps to compete with a monopolist and open the market to more entrants, generating only minor competitive restraints in the process. Its conduct was eminently reasonable; no one has suggested a viable alternative. ‘What could be more perverse than an antitrust doctrine that discouraged new entry into high concentrated markets?’<sup>158</sup>

#### IV. Analysis

##### A. Introduction

Determining whether to apply the *per se* rule or the rule of reason to a restraint of trade is far from simple, and courts have struggled with the problem since the inception of the Sherman Act. At the outset, it is imperative to understand that the essential inquiry of both standards remains the same: “Whether or not the challenged restraint enhances competition.”<sup>159</sup> No bright

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<sup>154</sup> See *id.* at 350 (Jacobs, J., dissenting). However, he quickly identified that the shift of pricing power “operated as a restraint only in the sense that Amazon faced pressure to adopt an agency model and to charge prices set by the five publishers, which of course remained in competition with each other, and with the publishers who account for the remaining [fifty-two] percent of the industry.” *Id.*

<sup>155</sup> *Id.* “But the consumer’s near-term preference for low prices is not an object of antitrust law. The district court charts the short-term price developments, treating the end of below-cost pricing as anticompetitive and observing with disapproval the natural tendency for prices to rise to competitive levels. The rule of reason promotes competition; it can be safely assumed that if competition sharpens, prices will take care of themselves.” *Id.*

<sup>156</sup> See *id.* at 350–51 (noting that a “removal of a barrier to entry reduces for the long term a market’s vulnerability to monopolization). These effects sound in the basic goals of antitrust law. Even if only quick-look analysis were appropriate in this case, these effects would vindicate Apple’s conduct.” *Id.*

<sup>157</sup> See *id.* (offering potential alternative theories that he then concludes were never really options for Apple).

<sup>158</sup> *Apple*, 791 F.3d at 352 (Jacobs, J., dissenting) (quoting *In re Text Messaging Antitrust Litig.*, 782 F.3d 867, 874 (7th Cir. 2015)).

<sup>159</sup> *Nat’l Collegiate Athletic Ass’n v. Bd. of Regents*, 468 U.S. 85, 85–86 (1984).

line separates the *per se* rule from rule of reason analysis.<sup>160</sup> Horizontal agreements among competitors to fix prices or divide markets are the only restraints explicitly recognized by the Supreme Court as *per se* unlawful.<sup>161</sup> When competitors collude to fix prices in a market, their motives become aligned, dominant, and create irresistible temptations<sup>162</sup> that threaten the “central nervous system of the economy.”<sup>163</sup> Resort to the *per se* rule is justified for such restraints because judicial experience enables courts to predict that their anticompetitive effects outweigh any procompetitive justifications under the rule of reason in all or almost all instances.<sup>164</sup>

This creates a two-step inquiry to determine whether a restraint falls within a *per se* category. First, is the arrangement between competitors, and does it fix prices or reduce output in the relevant market?<sup>165</sup> Second, is the arrangement one that courts have previously determined always or almost always restricts competition without the ability to increase economic efficiencies and render markets more competitive?<sup>166</sup>

This Section will argue that the Supreme Court should reverse the Second Circuit majority’s holding in *United States v. Apple*<sup>167</sup> for two reasons: (1) the *per se* rule is inappropriate for courts to apply to a novel restraint used to enter an emergent market; and (2) vertical conduct always needs to be analyzed under the rule of reason—even when it facilitates a horizontal cartel.

#### B. The *Per Se* Rule Does Not Apply To Novel Restraints With Non-Obvious Economic Effects

The Second Circuit’s use of the *per se* rule was inappropriate because both Apple’s unique

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<sup>160</sup> *Id.* at 86 n. 26.

<sup>161</sup> *Leegin*, 551 U.S. at 886.

<sup>162</sup> *Apple*, 791 U.S. at 347 (Jacobs, J., dissenting).

<sup>163</sup> *Socony-Vacuum Oil Co.*, 310 U.S. at 224–25 n. 59.

<sup>164</sup> *Leegin*, 551 U.S. at 886–87.

<sup>165</sup> *See id.*

<sup>166</sup> *See Broadcast Music, Inc.*, 441 U.S. 1.

<sup>167</sup> 791 F.3d 290.

combination of vertical agreements and the “nascent”<sup>168</sup> e-book industry presented the court with a novel restraint for which the *per se* rule is unfit.<sup>169</sup> The Supreme Court has encouraged courts to refrain from applying the *per se* rule when the lack of exposure to similar restraints makes the economic impact not immediately obvious.<sup>170</sup> Significantly, the government in *Apple*<sup>171</sup> conceded that Apple’s use of a combination of vertical arrangements created a restraint “no court ha[d] previously considered.”<sup>172</sup> Moreover, Judge Livingston herself stated that a rule of reason analysis may have been appropriate because the economic impact was not immediately obvious.<sup>173</sup> In his dissent, Judge Jacobs correctly pointed out the features that make Apple’s arrangement novel: “(a) a vertical relationship (b) facilitating a horizontal conspiracy (c) to overcome barriers to entry in a market dominated by a single firm (d) in an industry created by an emergent technology.”<sup>174</sup>

In *Broadcast Music, Inc. v. Columbia Broad. Sys., Inc.*,<sup>175</sup> the Supreme Court rejected the lower court’s use of the *per se* rule for conduct it labeled “price-fixing” because the Court “ha[d] never examined a practice like [it] before.”<sup>176</sup> Similarly, in *Sulfuric Acid*,<sup>177</sup> the Seventh Circuit distinguished the alleged price-fixing restraint from those deserving *per se* treatment because the arrangement involved a new market entrant in novel circumstances.<sup>178</sup> The court cautioned that

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<sup>168</sup> *Id.* at 329.

<sup>169</sup> *Id.*

<sup>170</sup> *Leegin*, 551 U.S. at 886–87 (“It should come as no surprise, then, that we have expressed reluctance to adopt *per se* rules with regard to restraints imposed in the context of business relationships where the economic impact of certain practices is not immediately obvious . . . . And, as we have stated, a ‘departure from the rule-of-reason standard must be based upon demonstrable economic effect rather than . . . upon formalistic line drawing.’”) (internal citations omitted).

<sup>171</sup> 791 F.3d 290.

<sup>172</sup> *Id.* at 343 (Jacobs, J., dissenting).

<sup>173</sup> *Id.* at 329 (citing *In re Sulfuric Acid Antitrust Litig.*, 703 F.3d 1004 (7th Cir. 2012)).

<sup>174</sup> *Id.* at 348 (Jacobs, J., dissenting).

<sup>175</sup> 441 U.S. 1.

<sup>176</sup> *Id.* at 10.

<sup>177</sup> 703 F.3d 1004.

<sup>178</sup> *See id.* at 1012 (“It is relevant that we have never seen or heard of an antitrust case quite like this, combining such elements as involuntary production and potential antidumping exposure. The difference is that the only aim and effect of the price-fixing agreement in *Socony-Vacuum* were to raise price; in this case the aim was to facilitate entry into the U.S. market, which would (and eventually did, as we’ll see) lower prices and prevent the shutdown of Canadian smelting operations, which would have reduced output and raised the price of sulfuric acid in the United

“[i]t 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.”<sup>179</sup>

Here, the Second Circuit majority’s use of the *per se* rule was erroneous given that Apple’s complex contracting arrangements were used to enter a novel market dominated by a monopolist firm.<sup>180</sup> Apple’s use of an agency model in the e-book industry (and really, the whole book industry in general) was an innovative practice, which no court had ever considered in the relevant market.<sup>181</sup> Further, no court could have had previous exposure to a firm attempting to enter into the “nascent” e-book market because Amazon developed a loss-leading practice that erected barriers to entry in order for it to capture ninety-percent of the market.<sup>182</sup> If the goals of antitrust laws are to foster competition and prohibit unreasonable restraints of trade, then by no means should Apple’s use of a unique business model to enter the e-book market be analyzed under a rule “designed for cases in which experience has convinced the judiciary that [the] particular type of business practice has no redeeming benefits ever.”<sup>183</sup>

Apple entered the e-book market through a series of vertical contracts with the publishers, landing them on a completely distinct horizontal plane of *retail* competition.<sup>184</sup> Its entry as a formidable competitor to Amazon *increased* competition, “i.e., greater *interbrand* competition, that [brought] with it net consumer benefits.”<sup>185</sup> As the district court noted, Apple’s entry into the

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States. The overall effect was thus to lower rather than to raise price. The plaintiffs' claim that the price would have been even lower without the shutdown agreements is doubtful, as we have said, because without the agreements the Canadian companies might not have entered the U.S. market.”); *see also Sylvania* at 53–54 n.22 (noting the potential for new entrant exception).

<sup>179</sup> *See id.* (citing *Leegin*, 551 U.S. at 886–87).

<sup>180</sup> *Apple*, 791 U.S. at 290.

<sup>181</sup> *See id.*

<sup>182</sup> I am not arguing that Amazon had an unlawful monopoly. It was merely benefiting from its innovation, however, by continuing a loss leading practice it made it nearly impossible for firms to enter the market and compete.

<sup>183</sup> *In re Sulfuric Acid Antitrust Litig.*, 703 F.3d at 1012.

<sup>184</sup> *Apple*, 791 U.S. at 341 (Jacobs, J., dissenting).

<sup>185</sup> *Leegin*, 551 U.S. at 913 (Breyer, J., dissenting).



market was “extremely beneficial to consumers and competition.”<sup>186</sup> Within two years, Amazon’s share of the e-book retail market dropped from ninety-percent to *sixty percent*, total e-book *output increased*, and overall e-book *prices fell*.<sup>187</sup>

The growth of e-commerce and the technological innovations that come with it have drastically changed how consumers function in our economy.<sup>188</sup> Apple’s iBookstore is a perfect example of how digital platforms have changed the economy: it was introduced (and still functions) as a digital platform for consumers to purchase and read e-books on the iPad (a revolutionary device itself).<sup>189</sup> Consumers depend on content platforms, such as the iBookstore, to “aggregat[e] content from diverse suppliers into convenient, feature-rich forums that are easy for consumers to use.”<sup>190</sup> However, firms that create innovative digital platforms must be able to assemble content suppliers in an efficient manner.<sup>191</sup> New platform entrants, such as Apple, often offer a combination of vertical restraints to multiple content suppliers (such as the publishers) to achieve these objectives.<sup>192</sup> Common examples include: fixed-price supply contracts; exclusivity contracts; “price ceilings to ensure sufficient demand; and . . . MFNs to attract sellers and mitigate the ability of competitors to undermine their entry.”<sup>193</sup> Even where these vertical restraints facilitate collusion on a different plane of competition, they also may genuinely “enhance overall efficiency and make markets more competitive.”<sup>194</sup>

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<sup>186</sup> The “creativity and commitment of Apple invested in the enhancement of a product like the iBookstore is extremely beneficial to consumers and competition.” *United States v. Apple Inc.*, 952 F.Supp.2d 638, 708 n. 69 (S.D.N.Y. 2013).

<sup>187</sup> *Apple*, 791 F.3d at 328.

<sup>188</sup> *See* Brief for International Center for Law & Economics and Scholars of Law and Economics as Amici Curiae Supporting Petitioner, *United States v. Apple, Inc.*, No. 15-565 (U.S. Dec. 2, 2015).

<sup>189</sup> *See id.*

<sup>190</sup> Brief for Petitioner at 1, *Apple, Inc. v. United States*, No. 15-565 (U.S. Dec. 2, 2015).

<sup>191</sup> *Id.* at 31. For example, a content platform company wishing to enter into a market to compete with Netflix would need to be able to “aggregate inputs from disparate suppliers” by using interdependent vertical agreements. *Id.*

<sup>192</sup> *See* Brief for International Center for Law & Economics and Scholars of Law and Economics as Amici Curiae Supporting Petitioner, *supra* note 188, at 11.

<sup>193</sup> *Id.*

<sup>194</sup> *Northwest Wholesale Stationers*, 472 U.S. at 294–96.

This is exactly why distinguishing between vertical and horizontal conduct is crucial before a court finds a violation of the Sherman Act. By holding Apple *per se* liable for facilitating and participating in the publishers' horizontal conspiracy, the Second Circuit majority was able to downplay and even overlook Apple's procompetitive justifications that completely differed from that of the publishers.<sup>195</sup> Moreover, the majority avoided dealing with the unusual features of Apple's arrangement by drawing a formalistic line rather than addressing the demonstrable economic effects of increased retailer competition and innovation in an emergent technological market.<sup>196</sup> An expansive *per se* rule can chill the modern economy by discouraging reasonable risks that foster competition.<sup>197</sup> In accordance with the Supreme Court's repeated caution against the *per se* rule, the Second Circuit should have refrained from holding Apple *per se* liable given the highly novel circumstances of its entry into the e-book market.

### C. The Rule of Reason Applies to Vertical Facilitators of Horizontal Cartels

Vertical conduct that facilitates a horizontal conspiracy cannot be condemned as *per se* illegal. The Supreme Court's overruling of *Dr. Miles* was the final straw in rejecting *per se* treatment for any vertical conduct.<sup>198</sup> *Leegin* explicitly stated that "[t]o the extent a vertical agreement setting minimum resale prices is entered upon to facilitate either type of [horizontal] cartel, it, too, would need to be held unlawful under *the rule of reason*."<sup>199</sup> However, the Second Circuit dismissed this statement as a non-binding "cryptic sentence" that did not affect "the law governing hub-and-spoke conspiracies."<sup>200</sup> Ignoring *Leegin's* direct signal enabled the majority to overlook the

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<sup>195</sup> Referring to the fact that the publishers did not present any plausible efficiencies such as market entry or increased output.

<sup>196</sup> *Sylvania*, 433 U.S. at 97.

<sup>197</sup> See Brief for International Center for Law & Economics and Scholars of Law and Economics as Amici Curiae Supporting Petitioner, *supra* note 188.

<sup>198</sup> See *Leegin*, 551 U.S. 877.

<sup>199</sup> *Id.* at 893.

<sup>200</sup> *Apple*, 791 F.3d at 324.

procompetitive effects of Apple’s vertical dealings with the publisher defendants and hold Apple *per se* liable as the “hub” of a horizontal price-fixing conspiracy.

In *Apple*, the only agreement deemed unlawful was the publisher defendants’ agreement to fix e-book prices.<sup>201</sup> Restraints imposed by agreements between competitors are horizontal and illegal *per se*.<sup>202</sup> The Supreme Court has made it clear that “a restraint is horizontal not because it has horizontal effects, but because it is the product of a horizontal agreement.”<sup>203</sup> Horizontal restraints are presumed anticompetitive because when competitors agree to fix prices or reduce output they are inherently posing a threat to competition within their market.<sup>204</sup> In *Apple*, the publishers competed on the same horizontal plane in the e-book market and agreed to raise prices.<sup>205</sup> Thus, the publisher defendants’ concerted action warranted *per se* liability.

However, the Second Circuit inappropriately relied on pre-*Leegin* cases to conclude that the “hub” should not be any less liable than the “spokes” in a price-fixing conspiracy.<sup>206</sup> “Hub-and-spoke” cases all rely on the central idea that the conspiracy’s exclusive purpose is to either illegally boycott or undermine a rival firm.<sup>207</sup> For example, in *Toys “R” Us*,<sup>208</sup> the Seventh Circuit held Toys “R” Us liable for facilitating a group boycott.<sup>209</sup> The court found that Toys “R” Us used its dominant market power to cut off the boycotted firm’s access to the manufacturers without any plausible justification for enhancing competition.<sup>210</sup> However, in its analysis, the court still paused

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<sup>201</sup> *Id.* at 339–40 (Loiher, J., concurring).

<sup>202</sup> *Bus. Elecs. Corp. v. Sharp Elecs. Corp.*, 485 U.S. 717, 730 (1988).

<sup>203</sup> *Id.* at 730 n.4 (noting that if a restraint were deemed horizontal merely because its anticompetitive *effects* are horizontal, then “there would be no such thing as an unlawful vertical restraint, since all anticompetitive effects are by definition horizontal effects”).

<sup>204</sup> *Id.* at 730.

<sup>205</sup> *Apple*, 791 U.S. 290.

<sup>206</sup> *Id.* at 325.

<sup>207</sup> Brief for Petitioner at 1, *Apple, Inc. v. United States*, No. 15-565 (U.S. Dec. 2, 2015).

<sup>208</sup> 221 F.3d 928.

<sup>209</sup> *Id.*

<sup>210</sup> *Id.*

to consider whether Toys “R” Us’s conduct was in pursuit of avoiding free riding—a procompetitive objective—and found that it was not.<sup>211</sup>

Similarly, in *Klor’s Inc. v. Broadway-Hale Stores, Inc.*,<sup>212</sup> a dominant retailer (Broadway-Hale) organized a group boycott against a small competing retailer (Klor’s).<sup>213</sup> The Court found that the agreement between Broadway-Hale and a combination of manufacturers and distributors destroyed interbrand competition by driving out retailers trying to compete in an open market.<sup>214</sup> Thus, Broadway-Hale was held *per se* liable for abusing its market power to organize a naked boycott against its competitors.<sup>215</sup>

In addition, the Second Circuit in *Apple* relied on *United States v. General Motors Corp.*,<sup>216</sup> in which a horizontal cartel (Chevrolet retailers) enlisted a “hub” (General Motors) to enforce its boycotting of rival competitors (discount retailer).<sup>217</sup> In *General Motors*, the Court found that the Chevrolet dealers had procured GM as a “hub” to terminate business dealings with discount retailers that strayed from the dealers’ horizontal agreement.<sup>218</sup> The Court ruled that “a facially vertical restraint imposed by a manufacturer only because it has been coerced by a ‘horizontal cartel’ agreement among his distributors is in reality a horizontal restraint.”<sup>219</sup> Thus, GM was held *per se* liable for using “facially vertical” conduct to enforce the horizontal agreements that originated between competitors.<sup>220</sup>

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<sup>211</sup> Brief for Petitioner at 1, *Apple, Inc. v. United States*, No. 15-565 (U.S. Dec. 2, 2015).

<sup>212</sup> 359 U.S. 207.

<sup>213</sup> *Id.*

<sup>214</sup> *Id.* at 212–14.

<sup>215</sup> *Id.*

<sup>216</sup> *United States v. Gen. Motors Corp.*, 384 U.S. 127 (1966).

<sup>217</sup> *Id.*

<sup>218</sup> *Id.*

<sup>219</sup> *Bus. Elecs. Corp.*, 485 U.S. at 734 n.5 (referring to *Gen. Motors Corp.*, 384 U.S. 127).

<sup>220</sup> See *Gen. Motors Corp.*, 384 U.S. 127; see also *Sylvania*, 433 U.S. at 58 n.28.

Apple, by contrast, assembled suppliers for its new e-book platform in pursuit of entering a market dominated by a single retailer. Unlike Toys “R” Us and Broadway-Hale, Apple did not already dominate the relevant market, and its entry increased competition in the relevant retailer market.<sup>221</sup> Additionally, unlike GM, Apple’s dealings were not “facially vertical” because Apple was not coerced by a horizontal cartel to enforce their naked restraint.<sup>222</sup> Rather, Apple’s conduct was in pursuit of a non-pretextual procompetitive objective—market entry.<sup>223</sup> Apple advanced its own business interests by entering into vertical agreements with the publishers to bring its new content platform to an emerging market. Significantly, Apple’s entrance into the e-book market benefitted consumers by increasing competition between e-book retailers and raising output.<sup>224</sup> Essentially, Apple’s conduct was not merely a facially vertical restraint that harmed competition between the publishers. Accordingly, Apple’s conduct does not fit in line with the pre-*Leegin* “hub-and-spoke” cases because its vertical role in the arrangement had inherent procompetitive effects on a new industry.

Few courts have analyzed “hub-and-spoke” conspiracies since *Leegin*.<sup>225</sup> Most recently, in *In re Musical Instruments & Equipment*,<sup>226</sup> the Ninth Circuit reconfirmed the importance of “not introducing needless confusion into antitrust terminology.”<sup>227</sup> Even though the Ninth Circuit had never recognized the existence of “hub-and-spoke” conspiracies, it wrote “to clarify the analysis of such conspiracies under [Section] 1.” First, the court acknowledged that sometimes “the line

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<sup>221</sup> In *Toys “R” Us*, the Seventh Circuit considered the procompetitive objective of avoiding free riding. See *Toys “R” Us*, 221 F.3d at 937–38.

<sup>222</sup> See generally *Bus. Elecs. Corp.*, 485 U.S. 717.

<sup>223</sup> *Leegin*, 551 U.S. at 913 (Breyer, J., dissenting).

<sup>224</sup> See *Apple*, 791 U.S. at 328.

<sup>225</sup> *Id.* at 346 (Jacobs, J. dissenting).

<sup>226</sup> 798 F.3d 1186.

<sup>227</sup> *Id.*

between horizontal and vertical restraints can blur.”<sup>228</sup> Nevertheless, the court concluded that a “hub-and-spoke” conspiracy is “simply a collection of vertical and horizontal agreements . . . , [a]nd once the conspiracy is broken into its constituent parts, the respective vertical and horizontal agreements can be analyzed either under the rule of reason or as violations *per se*.”<sup>229</sup>

Similarly, in *Toledo Mack*,<sup>230</sup> the Third Circuit—following *Leegin*’s instruction—held that the rule of reason standard applies even when the “purpose of [a] vertical agreement between a manufacturer and its dealers is to support illegal horizontal agreements between multiple dealers.”<sup>231</sup> Toledo Mack Sales and Service, Inc. (“Toledo”), a former authorized Mack Trucks, Inc. (“Mack” or “Mack Trucks”) dealer, alleged that a group of Mack dealers had agreed not to compete on prices, and further, that Mack Trucks vertically enforced that agreement by penalizing dealers that did not conform to the arrangement.<sup>232</sup> First, the Third Circuit found that Toledo presented enough direct evidence to conclude that a horizontal conspiracy not to compete existed among the Mack dealers.<sup>233</sup> The court then concluded that Mack itself entered into an anticompetitive agreement with its dealers.<sup>234</sup> The only question left for the court to decide was whether the agreement was an unreasonable restraint of trade. Relying on *Leegin*, the court determined that “[i]n contrast to horizontal price-fixing agreements between entities at the same

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<sup>228</sup> *In re Musical Instruments & Equip. Antitrust Litig.*, 798 F.3d 1186 (9th Cir. 2015) (providing that while certain horizontal agreements are so inherently anticompetitive that they are *per se* violations of the Sherman Act, “[v]ertical agreements, on the other hand, are analyzed under the rule of reason, whereby courts examine the facts peculiar to the business, the history of the restraint, and the reasons why it was imposed, to determine the effect on competition in the relevant product market”) (internal citations omitted).

<sup>229</sup> *Id.*

<sup>230</sup> 530 F.3d 204 (3d Cir. 2008).

<sup>231</sup> *Toledo Mack*, 530 F.3d at 225 (citing *Leegin*, 551 U.S. at 887) (“A horizontal cartel among competing manufacturers or competing retailers that decreases output or reduces competition in order to increase price is, and ought to be *per se* unlawful. To the extent a vertical agreement setting minimum resale prices is entered upon to facilitate either type of cartel, it, too, would need to be held unlawful under *the rule of reason*.”) (citations omitted and emphasis added).

<sup>232</sup> *See id.*

<sup>233</sup> *Id.*

<sup>234</sup> *Id.*

level of a product’s chain, the legality of a vertical agreement that imposes a restriction on the dealer’s ability to sell the manufacturer’s product is governed by the rule of reason.”<sup>235</sup>

As Judge Jacobs and others have recognized, the majority’s holding in *Apple* created a circuit split “and put [the Second Circuit] on the wrong side of it.”<sup>236</sup> Both *In re Musical Equipment* and *Toledo Mack* support the proposition that *Leegin* changed how such “hub-and-spoke” conspiracies are to be analyzed.<sup>237</sup> Whether the *per se* rule applies to a new market entrant whose vertical conduct facilitates a horizontal price-fixing conspiracy is a question that could drastically affect this nation’s economy.<sup>238</sup> The rule of reason embodies the true test of legality under the Sherman Act because it balances the competitive effects of a restraint to determine whether the challenged agreement is one that ultimately promotes or suppresses competition.<sup>239</sup> Thus, it is imperative that the more flexible rule of reason be applied when determining the liability of a vertical facilitator of a horizontal cartel.

## V. Conclusion

Section 1 of the Sherman Act protects competition by “outlaw[ing] only unreasonable restraints” of trade.<sup>240</sup> Over the past century, the Supreme Court has encouraged the use of the rule of reason analysis to “distinguish[] between restraints with anticompetitive effects that are harmful to the consumer and restraints stimulating competition that are in the consumer’s best interest.”<sup>241</sup> Accordingly, the Supreme Court has restricted its use of *per se* illegality to a narrow set of “horizontal agreements among competitors to fix prices . . . or to divide markets.”<sup>242</sup> Since

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<sup>235</sup> *Id.* at 225.

<sup>236</sup> *Apple*, 791 U.S. at 347 (Jacobs, J., dissenting).

<sup>237</sup> *Id.* at 345 (Jacobs, J. dissenting).

<sup>238</sup> See Brief for Petitioner, *Apple, Inc. v. United States*, No. 15-565 (U.S. Dec. 2, 2015).

<sup>239</sup> See *Board of Trade v. United States*, 246 U.S. 231 (1918).

<sup>240</sup> *Leegin*, 551 U.S. at 885 (quoting *Khan*, 522 U.S. at 10).

<sup>241</sup> *Id.* at 885–86.

<sup>242</sup> *Id.* (internal citations omitted).

the Supreme Court’s decision in *Leegin*, it has become necessary for courts to distinguish between vertical and horizontal conduct when determining whether the rule of reason or the per se rule should be the governing standard. However, the circuit courts’ interpretations of *Leegin* are inconsistent and have created great uncertainty concerning the “demarcation between lawful vertical conduct and *per se* illegal facilitations of a horizontal conspiracy.”<sup>243</sup> Consequently, companies—particularly new market entrants—may be counseled by attorneys to refrain from certain vertical contracting to circumvent the possibility of facing *per se* liability.<sup>244</sup> The Second Circuit’s expansion of the *per se* rule will certainly chill the economy by discouraging reasonable risks that foster competition. For “[w]hat could be more perverse than an antitrust doctrine that discouraged new entry into highly concentrated markets?”<sup>245</sup>

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<sup>243</sup> Brief for Petitioner at 29, *Apple, Inc. v. United States*, No. 15-565 (U.S. Dec. 2, 2015).

<sup>244</sup> *Id.*

<sup>245</sup> *Apple*, 791 F.3d at 352 (Jacobs, J., dissenting) (quoting *In re Text Messaging Antitrust Litig.*, 782 F.3d 867, 874 (7th Cir. 2015)).