No. 15-565

IN THE
# Supreme Court of the United States

APPLE INC.,
*Petitioner,*
v.

UNITED STATES OF AMERICA, *et al.*,
*Respondents.*

**On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit**

## BRIEF OF WASHINGTON LEGAL FOUNDATION AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER

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Date: December 2, 2015

## QUESTION PRESENTED

Whether vertical conduct by a disruptive market entrant, aimed at securing suppliers for a new retail platform, should be condemned as *per se* illegal under Section 1 of the Sherman Act, rather than analyzed under the rule of reason, because such vertical activity also had the alleged effect of facilitating horizontal collusion among the suppliers.

## TABLE OF CONTENTS

**Page**

## TABLE OF AUTHORITIES

**Page(s)**

**Cases:**

**Page(s)**



**Statutes:**



**Miscellaneous:**

## INTERESTS OF *AMICUS CURIAE*

Washington Legal Foundation (WLF) is a non-profit public interest law firm and policy center with supporters in all 50 states.[1] WLF devotes a substantial portion of its resources to defending free enterprise, individual rights, a limited and accountable government, and the rule of law.

To that end, WLF has appeared frequently in this Court to address the proper scope of the federal antitrust laws. *See, e.g., FTC v. Actavis*, 133 S. Ct. 2223 (2013); *Texaco, Inc. v. Dagher*, 547 U.S. 1 (2006). WLF also filed a brief in the case at bar when it was before the appeals court.

WLF is concerned that the decision below, if allowed to stand, would create excessive uncertainty among firms contemplating entry into new markets. As the lower courts conceded, the business practices engaged in by Petitioner Apple Inc. as it sought to enter the retail e-book market were legitimate, time-honored practices, regularly employed by new entrants. Yet, Apple now stands condemned as an antitrust law violator and faces the possibility of massive damages awards. As a consequence, firms—particularly smaller firms with less capital to risk—will be more hesitant in the future to enter new markets lest they too run afoul

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[1] Pursuant to Supreme Court Rule 37.6, WLF states that no counsel for a party authored this brief in whole or in part; and that no person or entity, other than WLF and its counsel, made a monetary contribution intended to fund the preparation or submission of this brief. More than 10 days prior to the due date, counsel for WLF provided counsel for Respondents with notice of its intent to file. All parties have consented to the filing; letters of consent have been lodged with the Court.

of the antitrust laws. That result runs counter to the purposes of the antitrust laws, which are designed to encourage precisely the sort of procompetitive conduct exemplified by entry into new markets.

The lower courts held that Apple's conduct was anticompetitive, but they arrived at that conclusion by adopting a *per se* unlawfulness analysis. WLF believes that invocation of the *per se* rule was wholly unjustified under the facts of this case, particularly given the lower courts' failure to cite a single case in which conduct even remotely similar to Apple's was determined to constitute an unreasonable restraint of trade. WLF worries that if invocation of the *per se* rule is upheld here, significant amounts of procompetitive conduct will be chilled.

WLF is particularly concerned by the lower courts' condemnation of Apple's inclusion of a most-favored-nation clause (MFN) in its separate agreements with five publishers. Businesses routinely use MFNs to protect themselves against losses they would incur if their competitors were subsequently granted more favorable contract terms than the terms they obtained. The lower courts' decisions call into question the continued viability of MFNs in a wide variety of business contexts.

## STATEMENT OF THE CASE

Amazon.com dominated the retail sales market for e-books in 2009, with a nearly 90% market share. Amazon maintained that share by establishing a $9.99 retail price for new releases and *New York Times* best sellers, a price that was well below the wholesale price

it paid for those titles. Other retail sellers, including Barnes & Noble, Inc., were incurring massive, unsustainable losses trying to compete with Amazon. Other companies had little incentive to enter the market if they would be required to establish a below-cost retail price.

Amazon's below-cost pricing upset major book publishers because they feared both that it was cutting into their sales of higher-priced hardcover books and that Amazon would soon be dictating wholesale price terms to them. In an effort to counter below-cost prices, the publishers on occasion denied Amazon e-book access to their newly released books until the books had been on sale for many months in hardcover form (a practice referred to as "windowing"). Indeed, the district court found that major publishers, in this pre-Apple era, were acting "collectively" to pressure Amazon to abandon its below-variable-cost pricing strategy. Pet. App. 126a.

In the years following Apple's market entry in January 2010 (via the opening of its iBookstore), the e-book industry flourished. E-book sales exploded, overall sales prices decreased, and retail competition increased. Amazon is still the leading player, but by 2011 Apple and Barnes & Noble together accounted for between 30% and 40% of e-book sales. Apple also began selling its iPad tablet in January 2010; the use of the iPad as an e-reading device has, in conjunction with the iBookstore, brought considerable innovation to the market. Moreover, "windowing" has been eliminated, and thus readers are no longer denied access to e-book versions of new releases.

The lower courts nonetheless found that the Agreements entered into by Apple with each of the five publisher defendants demonstrated a conspiracy in restraint of trade, in violation of Section 1 of the Sherman Act, 15 U.S.C. § 1. The district court found "compelling direct and circumstantial evidence that Apple participated in and facilitated a horizontal price-fixing conspiracy." Pet. App. 219a. "As a result," the district court concluded, the Respondents "have proven a *per se* violation of the Sherman Act." *Ibid.*

A divided Second Circuit panel affirmed. Pet. App. 1a-119a. The panel majority rejected Apple's contention that the district court erred in condemning Apple's conduct as a *per se* violation of the Sherman Act rather than examining that conduct under the rule of reason. *Id.* at 52a-69a. Although recognizing that antitrust challenges to vertical price restraints are generally examined under the rule of reason, and that Apple (as a retailer) had a vertical relationship with book publishers, the appeals court held that Apple should be held *per se* liable for supposedly orchestrating horizontal collusion among publishers. *Id.* at 57a ("[H]orizontal agreements with the purpose and effect of raising prices are *per se* unreasonable because they pose a threat to the central nervous system of the economy.").[2]

In support of its holding that Apple could be held

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[2] The appeals court made no mention of the fact that the district court explicitly *declined* to find that Apple itself sought to raise prices. *Id.* at 244a (stating that "[t]he record is equivocal on whether Apple itself desired higher e-book prices than those offered at Amazon.").

*per se* liable for orchestrating "horizontal" collusion, the appeals court cited cases in which the activities of all participants in "hub-and-spoke" conspiracies were condemned as *per se* Sherman Act violations, even though not all of the defendants were at the same level (*e.g.*, some were manufacturers or distributors while others were retailers). *Id.* at 55a-57a. It stated, "Because the reasonableness of a restraint turns on its anticompetitive effects, and not the identity of each actor who participates in imposing it, Apple and the dissent's observation that the Supreme Court has refused to apply the *per se* rule to certain vertical agreements is inapposite." *Id.* at 57a. The appeals court concluded, "[T]he question is whether the vertical organizer of a horizontal conspiracy designed to raise prices has agreed to a restraint that is any less anticompetitive than its co-conspirators, and can therefore escape *per se* liability. We think not." *Id.* at 62a.

The appeals court's affirmance hinged entirely on the *per se* liability finding. Although Judge Livingston stated that she would have reached the same result under a rule-of-reason analysis, Pet. App. 69a-82a, no other member of the panel agreed with her. Judge Lohier also voted to affirm the district court, but declined to join Judge Livington's rule-of-reason analysis. *Id.* at 90a-91a. He stated, "In my view, Apple's appeal *rises or falls* based on the application of the *per se* rule." *Id.* at 90a (emphasis added).

Judge Jacobs dissented. *Id.* at 91a-119a. He termed the district court's application of the *per se* rule a "decisive error":

> The district court ruled (and the majority affirm) that a vertical enabler of a horizontal price-fixing conspiracy is in *per se* violation of the antitrust laws. However, the Supreme Court teaches that a vertical agreement designed to facilitate a horizontal cartel "would need to be held unlawful *under the rule of reason*." *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 551 U.S. 893 (2007) (emphasis added).

*Id.* at 94a. He went on to conclude that Apple's conduct was unobjectionable under the antitrust laws, concluding that it was "unambiguously and overwhelmingly procompetitive." *Ibid.*

## SUMMARY OF ARGUMENT

The petition raises an issue of exceptional importance to free enterprise. Petitioner engaged in conduct that on its face has numerous procompetitive aspects: it created a new platform that enabled consumers to purchase and read e-books and that gave publishers a viable alternative to Amazon's stranglehold on the e-book market. Yet, according to the Second Circuit, all of those procompetitive effects are irrelevant when considering the government's Sherman Act claims because, the appeals court concluded, Apple's conduct constituted a *per se* violation of the antitrust laws. The Second Circuit's decision throws into doubt the legality of well-established business practices and runs directly counter to the purposes of the antitrust laws, which are designed to encourage precisely the sort of procompetitive conduct exemplified by entry into new markets. Review is warranted to determine whether

the antitrust laws actually demand such a counter-productive result.

As Petitioner has demonstrated, review is warranted to resolve the direct conflict—between the decision below and a decision from the Third Circuit—regarding application of the *per se* rule. WLF writes separately to focus on the conflicts between the Second Circuit's decision and this Court's decisions governing when restraints on trade are so unreasonable that they are subject to *per se* condemnation.

The rule of reason is "the accepted standard" for testing whether a business practice unreasonably restrains trade in violation of Section 1 of the Sherman Act, 15 U.S.C. § 1. *Leegin*, 551 U.S.C. at 885. Only a very limited number of restraints—those "that would always or almost always tend to restrict competition and decrease output"—are subject to *per se* rules that permit reviewing courts to skip the detailed economic analyses otherwise required by the rule of reason. *Id.* at 886. The Second Circuit held that Apple's conduct was a *per se* Section 1 violation despite the complete dissimilarity between that conduct and any conduct to which this Court has previously applied the *per se* rule.

Horizontal agreements among competitors to fix prices have long been among the small number of business practices deemed to constitute *per se* Section 1 violations. The lower courts applied the *per se* rule in this case on the basis of a finding that "Apple participated in and facilitated a horizontal price-fixing conspiracy." Pet. App. 219a. But the lower courts' characterization of Apple's conduct as orchestrating

"horizontal" price-fixing does not make it so. In particular, this Court's case law holds that price restraints agreed to by companies at different levels of the supply chain are "vertical" restraints whose lawfulness should be judged under the rule of reason. *Leegin*, 551 U.S. at 893. Review is warranted to resolve the conflict between *Leegin* and the decision below regarding whether alleged restraints agreed to by a single e-book retailer with several book publishers with which it contracted may properly be characterized as an orchestration of a horizontal restraint and thereby subjected to *per se* antitrust condemnation.

The Second Circuit sought to bolster its characterization of Apple's conduct as a *per se* illegal, and to downplay *Leegin*'s relevance, by citing several Supreme Court group-boycott decisions that applied *per se* antitrust analysis to all boycott participants—even though the boycott included both horizontal and vertical participants. Pet. App. 55a-57a (citing *Klor's, Inc. v. Broadway-Hale Stores, Inc.*, 359 U.S. 207 (1959); and *United States v. General Motors Corp.*, 384 U.S. 127 (1966)).

Those citations are inapposite. Neither *Klor's* nor *General Motors* ever used the terms "horizontal" or "vertical," let alone stated that a vertical participant can be subjected to *per se* antitrust liability for having facilitated horizontal price collusion. Even if the *per se* analysis applied in *Klor's* and *General Motors* can still be considered good law following *Leegin*, those decisions indicate at most that vertical participants in a group boycott are subject to the *per se* rule where the boycott lacks any plausible procompetitive benefits; they do not address vertical price restraints. *Leegin*

made clear that all vertical price restraints should be judged under the rule of reason, even when (as here) a vertical participant allegedly facilitates horizontal collusion. *Leegin*, 485 U.S. at 893.

Review is also warranted because the decision below calls into question the legality of many "most-favored-nation" clauses. Businesses regularly include MFNs in their supply contracts to ensure that they are offered terms that are no less favorable than the terms offered to their competitors. The lower courts conceded that Apple had a valid reason for insisting on MFNs from book publishers; the clauses protected Apple by granting it the right to lower prices in order to match the competition's prices. Pet. App. at 233a-234a. The Second Circuit nonetheless singled out the MFNs as playing a "pivotal role" in the supposed price-fixing conspiracy, by ensuring that publishers would demand that Amazon switch to an agency sales model. *Id.* at 21a-22a.

By pointing to the MFNs as the linchpin of Apple's *per se* antitrust violation, the Second Circuit called into question the right of businesses to insist on favorable pricing terms. Given the recognition among economists that MFNs often have procompetitive effects, the Second Circuit's application of the *per se* rule to Apple's MFNs is particularly problematic. While it may be possible in theory to draft an MFN that, on balance, proves anticompetitive, a conclusion that an MFN unreasonably restrains trade should be reached only after an MFN has been subjected to a full-fledged rule-of-reason analysis. Review is warranted in light of the widespread uncertainty created by the decision below regarding the legality of MFNs.

## REASONS FOR GRANTING THE PETITION

### I. Review Is Warranted to Determine Whether the *Per Se* Rule Is Properly Applied to Vertical Price Restraints that May Facilitate Horizontal Cartels

Apple contends that its entry into the e-book market had substantial procompetitive effects. The Second Circuit determined that any such procompetitive effects were irrelevant to its antitrust analysis because Apple's activities constituted a *per se* violation of the Sherman Act. Review of that determination is warranted because it conflicts directly with decisions from this Court and the federal appeals courts. Those decisions have held that while vertical price restraints may impose unreasonable restraints on trade under some circumstances (and thus may violate Section 1 of the Sherman Act), their lawfulness should be determined based on the rule of reason, not the *per se* rule.

#### A. The Lower Courts' Application of the *Per Se* Rule Conflicts with Decisions from this Court and Other Federal Appeals Courts

Section 1 of the Sherman Act prohibits "every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States." 15 U.S.C. § 1. Section 1 outlaws only "unreasonable" restraints. *State Oil Co. v. Kahn*, 522 U.S. 3, 10 (1997). The rule of reason is "the

accepted standard" for testing whether a practice unreasonably restrains trade in violation of § 1. *Leegin*, 551 U.S. at 885. The Court recently cautioned that "abandonment of the 'rule of reason' in favor of presumptive rules (or a 'quick look' approach) is appropriate only where 'an observer with even a rudimentary understanding of economics could conclude that the arrangement in question would have an anticompetitive effect on customers and markets.'" *Actavis*, 133 S. Ct. at 2237 (quoting *California Dental Assn. v. FTC*, 526 U.S. 756, 770 (1999)). "To justify a *per se* prohibition a restraint must have manifestly anticompetitive effects . . . and lack any redeeming virtue." *Leegin*, 551 U.S. at 886 (citations omitted).

The Court has made clear that the *per se* rule should be applied with great caution and only in the few cases where sufficient experience has shown that the conduct "always or almost always tend[s] to restrict competition and decrease output." *Northwest Wholesale Stationers, Inc. v. Pacific Stationery & Printing Co.*, 472 U.S. 284, 289-90 (1985). The reason for this is clear. When the *per se* rule is applied to an agreement, a claimant need not prove: that the alleged relevant market exists; that the accused parties have market power; that the accused parties' purpose is anticompetitive; or that the agreement has actual anticompetitive effects that outweigh procompetitive effects. Equally important, particularly in the complex context of the agreements at issue in this case, application of the *per se* rule bars a defendant from explaining its rationale for entering into the challenged agreement. The agreement is conclusively *presumed* to be illegal without inquiry into the exact type of harm

caused. *Id.* at 289.

The *per se* rule should thus only be invoked when its application generates a low risk of error—*i.e.*, to circumstances where the courts have consistently found unambiguously anticompetitive effects after applying the rule of reason to nearly identical conduct in prior cases:

> The object is to see whether the experience of the market has been so clear, or necessarily will be, that a confident conclusion about the principal tendency of a restriction will follow from a quick (or at least quicker) look, in place of a more sedulous one. And of course, what we see may vary over time, if rule-of-reason analyses in case after case reach identical conclusions.

*California Dental*, 526 U.S. at 780-81.

The limited number of restraints that the Court has deemed *per se* unlawful include horizontal agreements among competitors to fix prices, *Texaco*, 547 U.S. at 5; horizontal agreements to divide markets, *Leegin*, 551 U.S. at 886; and certain concerted refusals to deal or group boycotts. *Klor's*, 359 U.S. at 212. On the other hand, the Court has concluded that the rule of reason should be employed when examining the reasonableness of either maximum vertical price restraints (*Khan*) or minimum vertical price restraints (*Leegin*) because experience has demonstrated that such price restraints can often have significant procompetitive effects.

The lower courts held that Apple's conduct was *per se* illegal based on their conclusion that Apple orchestrated horizontal collusion. Pet. App. 219a; *id.* at 61a-62a. But the lower courts' characterization of Apple's conduct in that manner does not transform Apple into a horizontal participant subject to *per se* liability.

If one applies the terms "horizontal" and "vertical" in the manner in which this Court has normally used those terms, the agreement(s) entered into by Apple with the five publishers were "vertical" in nature. To the extent that Apple orchestrated horizontal collusion among publishers, the Court's case law would categorize the agreement as a "vertical" price restraint. As the Court explained in rejecting claims that an agreement should be classified as a "horizontal" (thereby triggering *per se* liability) when a manufacturer allegedly facilitates an agreement among distributors of its products to maintain horizontal trade restraints:

> [Use of the word "horizontal" to describe such an agreement] introduces needless confusion into antitrust terminology. 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.

*Business Electronics Corp. v. Sharp Electronics Corp.*, 485 U.S. 717, 730 (1988). Accordingly, Apple's alleged facilitation of horizontal collusion among publishers

(which are "firms at different levels of distribution" from Apple) should—under the terminology traditionally employed by the Court—be classified as a "vertical" price restraint.

*Leegin* well illustrates the Court's traditional understanding of the term "vertical." The defendant in that case, a manufacturer of leather goods, was accused by the plaintiff (a retailer that previously sold the manufacturer's products) of having entered into "price-fixing agreements" with its other retailers. *Leegin*, 551 U.S. at 884. Even though the leather-goods manufacturer was alleged to have facilitated horizontal collusion among retailers, the Court classified the price-fixing allegations against the manufacturer as involving "vertical" minimum price restraints subject to the rule of reason. *Id.* at 887-94.[3]

*Leegin* stated explicitly that a firm's price agreement(s) with companies operating at a different level of distribution should be treated as "vertical" agreements (and assessed under the rule of reason) even when the agreements are alleged to "facilitate" a cartel among firms competing with one another at the same level of distribution. *Id.* at 892. The Court said that "[t]o the extent that a vertical agreement setting minimum resale prices is entered upon to facilitate" a horizontal price-fixing agreement at either the manufacturer or retailer level, it "would need to be held

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[3] The Court overruled *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911), which had held that minimum vertical price restraints were *per se* illegal under Section 1 of the Sherman Act. *Leegin*, 551 U.S. at 907.

unlawful *under the rule of reason*." *Id.* at 893 (emphasis added).

Review is warranted to resolve the conflict between *Leegin* and the Second Circuit regarding whether alleged facilitation of horizontal price collusion should be classified as a vertical price restraint subject to the rule of reason or (as the Second Circuit held) should trigger *per se* liability. As Judge Jacobs argued in his dissent below, "*Leegin* is animated by the 'appreciated differences in economic effect between vertical and horizontal agreements.'" Pet. App. 104a (quoting *Leegin*, 551 U.S. at 888). He concluded, "After *Leegin*, we cannot apply the *per se* rule to a vertical facilitator of a horizontal price-fixing conspiracy; such an actor must be held liable, if at all, 'under the rule of reason.'" *Ibid* (quoting *Leegin*, 551 U.S. at 893).

The Second Circuit's application of the *per se* rule to alleged "vertical facilitators" of horizontal price-fixing conspiracies also conflicts with post-*Leegin* decisions from other federal appeals courts. The Third Circuit understood *Leegin* to mean that "[t]he rule of reason 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." *Toledo Mack Sales & Services, Inc. v. Mack Trucks, Inc.*, 530 F.3d 204, 225 (3d Cir. 2008). Hence, the Third Circuit held, in light of *Leegin*, that the legality of a vertical agreement entered into between a truck manufacturer and its dealers to facilitate a horizontal price-fixing agreement (whereby the manufacturer allegedly agreed to punish dealers found to have

"cheated" on the price-fixing agreement) should be judged under the rule of reason. *Ibid.* Indeed, the Second Circuit explicitly acknowledged the tension between its decision and *Toledo Mack* regarding application of the *per se* rule. Pet. App. 61a n.20. Its only effort to distinguish *Toledo Mack* was a conjecture that perhaps the Third Circuit might overrule its decision were the issue to arise again within that circuit. *Ibid.*

More recently, the Fifth Circuit (in a case in which steel manufacturers were alleged to have joined a group boycott organized by distributors against a disfavored distributor) also interpreted *Leegin* as having stated that its holding (that the rule of reason applies to vertical price restraints) "would extend to vertical agreements that facilitate horizontal conspiracies to increase prices." *MM Steel, L.P. v. JSW Steel (USA) Inc.*, ___ F.3d ___, No. 14-20267, slip op. at 17 (5th Cir., Nov. 25, 2015). According to the Fifth Circuit, *Leegin* stated that "vertical agreements to *regulate prices* that facilitate horizontal agreements to *regulate prices* 'too, would need to be held unlawful under the rule of reason.'" *Id.* at 18 (emphasis in original) (quoting *Leegin*, 551 U.S. at 893). Review is also warranted to resolve the conflict between the decision below and the decisions of the Third and Fifth Circuits regarding *Leegin*'s application to vertical facilitators of horizontal price-fixing agreements.

### B. The Second Circuit Misconstrued Relevant Case Law from this Court

The Second Circuit appeared to concede that the language from *Leegin* quoted above *could* be interpreted as requiring that all price restraints agreed to by a vertical participant should be evaluated under the rule of reason rather than the *per se* rule, regardless whether the vertical participant's actions might serve to facilitate a horizontal price-fixing conspiracy. Pet App. 59a-60a. The appeals court ultimately rejected that argument, however, dismissing the relevant language from *Leegin* as "cryptic" and asserting that such an interpretation would be inconsistent with numerous previous Court decisions that *Leegin* did not claim to be overruling. *Id.* at 60a. The Second Circuit's reasoning was based on a fundamental misunderstanding of the Supreme Court case law on which it relied. Properly understood, that case law is fully consistent with construing *Leegin* to preclude application of the *per se* rule here.

The Second Circuit relied principally on two decisions—*Klor's* and *General Motors*—in which the Court held that all participants in a group boycott (*i.e.*, both horizontal and vertical participants) were guilty of a *per se* violation of the antitrust laws. Pet. App. 55a-58a. *General Motors* held that the *per se* rule applied to an agreement by a car manufacturer with its dealers to take action against any dealer that violated an agreement among the dealers not to sell cars at discounted prices. 384 U.S. at 140. *Klor's* involved allegations that a department store orchestrated a group boycott against one of its competitors by

persuading manufacturers of electronics equipment (who were major suppliers of the department store) not to sell their products to the competitor. *Klor's* held that the competitor's allegations against both the boycotting manufacturers and the department store stated claims for *per se* violations of the antitrust laws. 359 U.S. at 211-12.

According to the Second Circuit, *Klor's* and *General Motors* are examples of "hub-and-spoke agreements"[4] and support the proposition that participation in such agreements constitutes a *per se* antitrust violation—without regard to each participant's level in the distribution chain. Pet. App. 55a-58a. The appeals court asserted that *Leegin* should not be understood to require application of the rule of reason to vertical price restraints in which the vertical participant is alleged to have facilitated a horizontal price-fixing scheme, because that reading of *Leegin* would effectively "overturn *General Motors* and *Klor's*." *Id.* at 60a. It asserted that this Court "does not normally overturn, or so dramatically limit, earlier authority *sub silentio*." *Ibid* (quoting *Shalala v. Ill. Council on Long Term Care, Inc.*, 529 U.S. 1, 18 (2000)).

The Second Circuit has badly misconstrued *Klor's* and *General Motors*. Both decisions focused solely on naked group boycotts. While the Court in

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[4] A "hub-and-spoke agreement" generally refers to a business relationship in which a "hub" firm directly facilitates an anticompetitive agreement among horizontal competitors (the "spokes").

each instance applied the *per se* rule to all participants in the boycott, the Court never suggested that its application of *per se* liability should apply outside of the context of group boycotts. In particular, neither case has anything to say about vertical price restraints—including whether there are any circumstances under which such restraints should be subject to the *per se* rule.[5] Accordingly, when *Leegin* held that all antitrust challenges to vertical price constraints should be analyzed under the rule of reason, the Court had no need to repudiate anything it had said in *Klor's* or *General Motors*.

The Second Circuit cited *Atlantic Richfield Co. v. USA Petroleum Co.*, 495 U.S. 328 (1990), for the proposition that "[i]t is the type of restraint Apple agreed to impose"—not whether the restraint should be

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[5] Indeed, neither *Klor's* nor *General Motors* uses the terms "horizontal" or "vertical." Thus, neither decision provides support for the Second Circuit's contention that a vertical price restraint warrants application of the *per se* rule based on a finding that the vertical participant has "actively facilitated" a horizontal price-fixing conspiracy among direct competitors. Even assuming that *Klor's* and *General Motors* are still good law, they stand at most for the proposition that a vertically situated party that engages in naked facilitation of a group boycott is subject to the *per se* rule; they do not address vertical price restraints.

The Fifth Circuit's recent *MM Steel* decision drew that precise distinction between *Leegin* and *Klor's*/*General Motors*. It interpreted *Leegin* as mandating rule-of-reason analysis for all vertical *price* restraints—even vertical price restraints that arguably facilitate a horizontal price-fixing conspiracy—but as leaving intact the holdings of *Klor's* and *General Motors* that a vertical agreement for no purpose other than to support a group boycott is subject to the *per se* rule. *MM Steel*, slip op. at 17-18.

characterized as vertical or horizontal—"that determines whether the *per se* rule or the rule of reason is appropriate." Pet. App. 55a. *Atlantic Richfield* said no such thing. To the contrary, the Court noted that although the ultimate aim of both rules is the same—both rules are methods of determining whether a restraint is "unreasonable"—the *per se* rule is applied only after extensive "experience with a particular kind of restraint enables the Court to predict with confidence that the rule of reason will condemn it." *Atlantic Richfield*, 495 U.S. at 342.

Thus, although all minimum price restraints are likely to lead to at least some price increases, the Court applies a distinctly different antitrust analysis depending on whether the price restraint is properly characterized as horizontal or vertical. The Court applies the rule of reason to a price restraint properly characterized as vertical, not because it has determined in advance that the restraint is reasonable but because experience has not demonstrated that almost all vertical price restraints are anticompetitive. *See Leegin*, 551 U.S. at 888 (noting that "horizontal restraints are generally less defensible than vertical restraints"); *Business Electronics*, 485 U.S. at 734 (rejecting the "notion of equivalence between the scope of horizontal *per se* illegality and that of vertical *per se* illegality."). A court is permitted to analyze whether, under the rule of reason, Apple's agreements with the five publishers unreasonably restrained trade. But the appeals court's efforts to short-circuit that analysis by applying *per se* analysis to vertical arrangements that facilitate horizontal collusion conflict with the Court's antitrust case law and thus warrant review.

## II. Review Is Warranted Because the Decision Below Threatens to Disrupt Well-Established Business Practices, Including Use of Most-Favored-Nation Clauses

The Court has repeatedly explained that "the *per se* rule is appropriate only after courts have had considerable experience with the type of restraint at issue . . . and only if courts can predict with confidence that it would be invalidated in all or almost all instances under the rule of reason." *Leegin*, 551 U.S. at 887-88. It has "expressed reluctance to adopt *per se* rules with regard to restraints where the economic impact of certain practices is not immediately obvious." *Id.* at 887. The Second Circuit appears not to have heeded any of that cautionary language. It applied the *per se* rule to Apple's conduct even though it lacked *any* "experience with the type of restraint at issue." Indeed, it failed to cite a single prior case in which conduct even remotely similar to Apple's was determined to constitute an unreasonable restraint of trade.

The *per se* condemnation of Apple's conduct is particularly troubling because there is no dispute that the practices engaged in by Apple were legitimate, time-honored practices routinely employed by businesses entering a new field. Review is warranted because the decision below threatens to disrupt such traditional and procompetitive practices.

Apple's potential entry into the e-book market coincided with the scheduled January 2010 launch of the iPad tablet device. Not surprisingly, Apple did not want to enter the market without reasonable

assurances that its business would be profitable. Pet. App. 144a. By definition, the business would not be profitable if Apple purchased e-books at wholesale prices and then was forced to match Amazon's below-cost pricing. It thus determined that its business interests required that its contracts with publishers include three essential elements: (1) an agency model (*i.e.*, Apple would sell e-books at whatever price the publisher established, with Apple retaining a commission equal to 30% of the sales price), *id*. at 156a; (2) a most-favored-nation clause (*i.e.*, a guarantee that Apple could match the lowest retail price listed on any competitor's e-bookstore), *id.* at 161a-162a; and (3) price caps (to restrain the publishers' desire "to raise e-book prices sky-high"). *Id.* at 170a. The agreements Apple separately negotiated with the five publishers included all three elements.

The Second Circuit did not dispute that each of the three elements served Apple's independent business interests and facilitated its entry into the e-book market. The appeals court nonetheless concluded that by signing the agreements with the publishers, Apple was *per se* liable for orchestrating a horizontal price-fixing conspiracy. Pet. App. 4a. The court concluded that Apple knew that the publishers would use Apple's entry into the e-book market as leverage to force Amazon to switch to an agency model—thereby permitting the publishers to establish retail prices considerably higher than the prices Amazon had established (a nearly-uniform $9.99 retail price for new releases and best-sellers). *Id.* at 65a.

Review is warranted because the Second

Circuit's imposition of *per se* antitrust liability on a market entrant threatens to deter future potential market entrants, a result at odds with the pro-competitive purposes of the antitrust laws. *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 594 (1986) (warning that courts should avoid antitrust remedies that "chill the very conduct the antitrust laws are designed to protect"). Companies are willing to enter into competition against incumbent businesses only if they are permitted to employ contractual tools designed to provide a reasonable prospect of profitability and without thereby incurring *per se* antitrust liability.

WLF is particularly concerned by the lower courts' condemnation of Apple's inclusion of a most-favored-nation clause (MFN) in its separate agreements with the publishers. MFNs are routinely used by businesses to protect themselves against losses they would incur if their competitors were subsequently granted more favorable contract terms. *See, e.g.,* Martha Samuelson, et al., *Assessing the Effects of Most-Favored Nation Clauses*, ABA Section of Antitrust Law Spring Mtg. 2012 (March 28, 2012). The Second Circuit nonetheless singled out the MFNs as playing a "pivotal role" in the supposed price-fixing conspiracy, by ensuring that publishers would demand that Amazon switch to an agency sales model. Pet. App. 21a-22a.

By pointing to the MFNs as the linchpin of Apple's *per se* antitrust violation, the Second Circuit called into question the right of businesses to insist on equally favorable pricing terms. Moreover, the appeals

court's contention that Apple utilized the MFNs as a means of ensuring price increases—and not as a means of ensuring that it would be offered terms no less favorable than those offered to its competitors—is inconsistent with the record.[6]

Economists recognize that MFNs often have procompetitive effects. For example, they may create efficiencies by reducing bargaining costs—by obtaining an MFN provision, a purchaser can eliminate the need to constantly renegotiate prices to meet changing market conditions. Samuelson at 2. Because of the potential for MFNs to enhance competition, courts regularly assess antitrust challenges to MFNs under a the rule of reason. Anthony J. Dennis, "Most Favored Nation Contract Clauses Under the Antitrust Laws," 20 U. DAYTON L. REV. 821 (1995).

The Second Circuit's application of the *per se* rule ignored the potential procompetitive benefits of Apple's MFNs.[7] The appeals court condemned the MFNs because they allegedly facilitated retail price increases—despite the absence of any finding that Apple adopted the MFNs for the purpose of raising prices. Review is warranted in light of the widespread

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[6] The district court concluded that "[t]he record is equivocal on whether Apple itself desired higher e-book prices than those offered at Amazon." *Id.* at 244a.

[7] In light of the ubiquity of MFNs and the paucity of case law finding any such clause to constitute an unreasonable restraint of trade, the Second Circuit's application of the *per se* rule to Apple's MFNs cannot be reconciled with this Court's repeated edicts cautioning against resort to the *per se* rule.

uncertainty created by the Second Circuit's decision regarding the legality of MFNs.

## CONCLUSION

The Court should grant the Petition.

Respectfully submitted,

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December 2, 2015