UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

IN RE: ELECTRONIC BOOKS ANTITRUST LITIGATION	:	11-md-02293 (DLC)
This Document Relates to:	:	
ALL ACTIONS	:	

APPLE INC.'S REPLY IN SUPPORT OF MOTION TO DISMISS THE CONSOLIDATED AMENDED CLASS ACTION COMPLAINT

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INTRODUCTION

Plaintiffs' Opposition, like their Complaint, consistently and intentionally blurs the critical factual distinctions that exist between Apple and the Publisher Defendants, simply referring generically to "Defendants" in critical allegations to mask the fatal deficiencies of their specific allegations as to Apple. The case against Apple relies almost exclusively on snippets from two responses by Apple's former CEO to members of the press shortly after the announcement of the iPad, excerpts that reveal nothing about Apple's participation in a purported horizontal conspiracy. Building on that false foundation, and spinning a just-so tale in which the single-purpose black-and-white Kindle eBook reader somehow posed a mortal threat to the multi-purpose, full-color, audio-visual iPad, Plaintiffs allege that Apple orchestrated an elaborate, multi-step hub and spoke conspiracy to protect the iPad from possible failure by undercutting Amazon's eBook business. This theory is based on mischaracterization, not plausible factual allegations.

Plaintiffs ignore Apple's very different role and incentives in the market that render Plaintiffs' hub and spoke conspiracy wholly implausible. Plaintiffs proffer a conspiracy with three distinct "steps" (Opp. at 1) aimed at "forc[ing] Amazon to abandon its [below-cost] pricing" (¶ 4), and yet Apple, the purported "*hub*" of the alleged conspiracy (¶ 11), is not even on the scene for the first step (when the publishers allegedly agreed to "window" eBooks) and is off-stage for the crucial third act (Amazon's unilateral decision to abandon below-cost pricing and become a publisher agent). The actor who appears and departs in the middle scene of a three-act play is an odd choice for "star" billing. Yet Plaintiffs' 80-page Complaint and 58-page Opposition fail to plausibly allege or explain Apple's involvement in a book-industry-wide conspiracy to "force" Amazon to do anything, much less alter its business model or fix prices.

Unlike the Publishers, Apple had no books to "window," and, as an agent compensated on

commission, no need to compel Amazon to abandon a below-cost pricing strategy that was allegedly harming the Publishers' physical book business. The Complaint never alleges that Apple had discussions with Amazon, nor any involvement in the Publishers' alleged "window-ing" threats to Amazon (which took place after Apple was locked into the agency agreements). In short, the Complaint alleges no Apple involvement in acts serving the alleged purpose of the purported conspiracy, which was *forcing Amazon to raise prices*.

Plaintiffs must offer "allegations plausibly suggesting (*not merely consistent with*) agreement" – a standard that demands sufficient *factual* allegations to "nudge[] their claims" from consistent to "plausible," *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 557, 570 (2007) (emphasis added), and not just "'conclusory allegations or legal conclusions masquerading as factual conclusions,'" *Faber v. Metro. Life Ins. Co.*, 648 F.3d 98, 104 (2d Cir. 2011). Here, when stripped of unsupported conclusion and spin, the factual allegations depict *procompetitive* conduct: Apple gave consumers and publishers alike a choice (and prompted a surge in eBook demand) in a market dominated by Amazon with over 90% of eBook sales. The iBookstore offered every publisher, big or small, the same basic terms – for a 30% commission Apple would sell the publisher's books as an agent. The introduction of the multi-feature iPad, combined with the creation of the iBookstore, launched an additional eBook distribution platform. The agency model, which Apple had used with great success with the App Store, left pricing decisions with the principal – here, the individual publisher – and has long been held perfectly legal. *See, e.g.*, *Morrison v. Murray Biscuit Co.*, 797 F.2d 1430, 1437 (7th Cir. 1986) (agency agreements are "no more a device for evading the Sherman Act than is telling one's sales clerk what price to mark on a bag of sugar rather than letting him decide for himself").

Plaintiffs nevertheless characterize the vertical agency agreements here as a *horizontal in-*

dustry-wide price-fixing agreement with Apple as the hub. The allegation that Apple served as a hub in a conspiracy of established market players is far-fetched and implausible. Apple was a new entrant with no eBook market power, with virtually no involvement in the book business, electronic or physical, and no *coercive* power over the Publishers. With no stick, Apple could offer only the attractive carrot of a new eBook distribution opportunity, which each Publisher could (and did) individually accept or reject without any other repercussions from Apple. Nor did the agency agreements prevent the Publishers from competing with each other on price; indeed, while Apple negotiated pricing limitations to ensure that each eBook was priced well below its physical counterpart, Plaintiffs have alleged no inter-Publisher restraints.

In addition, Apple negotiated a narrow "Most Favored Nation" or MFN clause in its agency agreements to ensure that its customers could receive competitive pricing. Plaintiffs' repeated *characterization* of the MFN as "preventing a publisher from offering a lower price" (*see, e.g.*, Opp. at 26) is contradicted by the *facts* pleaded. As the Steve Jobs quote cited by Plaintiffs clearly states, Apple could require a publisher to match a *lower* price on a title offered elsewhere – "if anybody else is selling the books *cheaper than we are*, then we can *sell them at the lower price too*." ¶ 18 (emphases added). The MFN simply allowed Apple to require that iBookstore pricing remain competitive for an eBook title, a reasonable protection essential to Apple's entry into a market dominated by a 90% incumbent pricing below cost. Plaintiffs fail to explain how a provision *requiring* individual title price competition can be transformed into one barring it.

Plaintiffs say they "take no issue with Apple's decision to begin retailing eBooks." Opp. at 52. At the same time, they threaten Apple with treble damages based on nothing more than Apple's lawful agency agreements. Apple saw an opportunity to offer publishers an additional platform for distributing eBooks. That Apple's strategy was a smart business maneuver – having

nothing to do with a conspiracy to coerce Amazon and everything to do with assuring that *if* Apple entered eBooks it would not spill red ink, as Plaintiffs themselves admit (¶ 114) – is not just an alternative explanation or a competing inference; it is the "obvious alternative explanation" as per *Twombly*. 550 U.S. at 567. Plaintiffs' attempt at "spin" contradicts the factual allegations they plead, and with no plausible theory of Apple as a "hub," nor any allegations linking Apple to Amazon's higher prices, the Complaint should be dismissed as to Apple.

ARGUMENT

I. No Horizontal Price-Fixing Conspiracy Is Plausibly Alleged in Connection with Apple's Vertical Agency Agreements

A. Apple's Vertical Agency Agreements Facilitated Entry into a Concentrated Market, Are Perfectly Legal, and Were Not a Means to Limit Price Competition Among Publishers

"Genuine contracts of agency" are not "violations of the Anti-Trust Act" as "a matter of principle." *United States v. Gen. Elec. Co.*, 272 U.S. 476, 488 (1926). Plaintiffs' efforts to transform Apple's separately negotiated, bilateral agency contracts into a "plausible" horizontal price-fixing conspiracy are unsupported by any factual allegations. The agency method of doing business – simply taking a percentage cut of revenue from products sold on behalf of others, rather than trying to buy and resell those products – is not novel or unfamiliar. Indeed, as Plaintiffs admit, Apple had used the model to great success in its App Store before opening the iBookstore. *See* ¶ 118.

The agency agreements do not *horizontally fix prices*: Each agreement was entered into with a single publisher, which individually sets prices for its own eBooks. Plaintiffs agree that Apple "exercise[d] *no discretion*" over those price decisions (¶ 224 (emphasis added)), which were subject to prenegotiated *limits* on a maximum price a Publisher could charge compared to the physical book price *of the same title*, ensuring that eBooks remained competitive against

physical books (¶ 127). To say these agreements *horizontally* fixed prices is demonstrably wrong; they had absolutely no limiting impact on interbrand competition among publishers, who could – and did – engage in *price competition against each other* on the enormous number of titles they offered. *See* ¶ 203(b) (showing differing average eBook prices by publisher).

Plaintiffs claim that "any horizontal conspiracy to fix prices is *per se* illegal" even if the prices allegedly fixed are "maximum prices." Opp. at 50. They do not explain how Apple's entry into a series of vertical agreements became a horizontal conspiracy. The "obvious alternative explanation" (*Twombly*, 550 U.S. at 567) is that Apple, having given up pricing authority, negotiated price caps to protect itself in each of its arm's-length transactions with Publishers – hardly the makings of a horizontal conspiracy.[1]

Plaintiffs also try to transform Apple's narrow MFNs from an agreement allowing Apple to require a publisher to *match a lower price* on a particular title offered elsewhere, into an agreement to "ensure those higher [eBook] prices would be the same higher prices if offered through other distributors – such as Amazon." Opp. at 26. The assertion flatly contradicts the *facts* Plaintiffs pleaded – in particular Steve Jobs's repeatedly cited comment about Apple being able to "*sell [eBooks] at the lower price too*" if others did (¶ 18 (emphasis added)), which is not a description of price fixing. *See Morrison*, 797 F.2d at 1430 ("a homeowner does not violate [the Sherman Act] when he tells his broker at which price to sell his home," and "if a real estate broker complained that his principal was allowing another broker to sell the same property at a lower price," "[t]hat would not make the brokerage agreement price fixing"). In any event, the MFNs at issue did not in any way limit inter-Publisher competition or "fix" prices.

[1] *Arizona v. Maricopa County Medical Society*, 457 U.S. 332 (1982), on which Plaintiffs rely to argue that maximum prices constitute a *per se* violation, applies only "once a [horizontal] price-fixing agreement [i]s proved," *id*. at 345, and Apple is a vertical, not a horizontal player. Ever since *State Oil Co. v. Khan*, 522 U.S. 3, 22 (1997), maximum vertical price fixing has been subject to the rule of reason.

The *facts* about the MFN provisions, then, undermine Plaintiffs' theories. After all, if Apple knew that a conspiracy would force Amazon to abandon below-cost pricing, why would Apple seek the power to compel the Publishers to match those prices on the agency model? As much as Plaintiffs try to avoid dismissal by painting Apple's motion as one dependent on resolving "competing inferences," that is not the problem here; the problem is the "facts alleged" are "not only inadequate to support [plaintiffs'] conclusion, they contradict it." *Priestly v. Headminder, Inc.*, 647 F.3d 497, 506 (2d Cir. 2011).

B. The Presence of Identical Agreements Does Not Plausibly Suggest That Apple Is the "Hub" of a Horizontal Conspiracy

Plaintiffs argue that the allegations that the agency agreements were "identical" and were "*negotiated at the same time*" support a claim of conspiracy. Opp. at 2. Pleading conduct "merely consistent with" conspiracy is insufficient. *Twombly*, 550 U.S. at 557. Time and time again, courts have warned "against false inferences from identical behavior." *Id. at* 554. Those precepts are all the more powerful here, where Plaintiffs never dispute (and in fact, themselves allege) that (1) each Publisher had its *own* independent interests in dealing with Apple, namely expanding eBook distribution opportunities beyond Amazon (¶ 15); and (2) the iPad launch was "fast approaching" and left little time for drawn-out haggling (¶ 8). Particularly under these circumstances, any similarity in agreements does not plausibly suggest a conspiracy. *See, e.g.*, *In re Elevator Antitrust Litig.*, 502 F.3d 47, 52 (2d Cir. 2007) ("Similar contract terms can reflect similar bargaining power and commercial goals (not to mention boilerplate)" and "can suggest competition at least as plausibly as it can suggest anticompetitive conspiracy."); *In re Ins. Brokerage Antitrust Litig.*, 618 F.3d 300, 330, 350-51 (3d Cir. 2010) ("similar confidentiality agreements [in] vertical contracts" reflects "brokers' power" to "adopt[] [provisions] to protect [their] own, lucrative agreements" and did not "plausibly imply an industry-wide conspiracy"

even where agreements were negotiated through "disclosure of information" to other suppliers).

Nevertheless, Plaintiffs rely on "identical agreements" allegations to support their entire theory. They claim that "Defendants' conduct" (again, lumping Apple with the Publishers) "starkly resembles the conduct sufficient to prove antitrust conspiracies in *Interstate Circuit* and *Toys 'R' Us*" since, in the former case, the "movie distributors simultaneously negotiated and agreed to identical contract terms," and it "'it taxes credulity to believe that the several distributors would'" have "'accepted [with] substantial unanimity'" without "'some understanding that all were to join.'" Opp. at 20, 3 (citing *Interstate Circuit, Inc. v. United States*, 306 U.S. 208 (1939); *Toys "R" Us, Inc. v. FTC*, 221 F.3d 931 (7th Cir. 2000)).

Not only are *Interstate Circuit* and *Toys "R" Us* inapposite, they powerfully illustrate why Plaintiffs' allegations against Apple lack merit. Unlike the defendants in those cases, Apple did not seek to leverage preexisting market power over *other parties it was already dealing with* to *force* them into accepting price and output restrictions in *a different market segment*. Yet that is what Interstate Circuit did, using its "complete monopoly of first-run theaters" to force its movie distributors to agree to raise prices – to exactly 25 cents – for showings in second-run theaters, thereby capitalizing on and protecting Interstate Circuit's first-run monopoly. *See* 306 U.S. at 215, 221-27. Meanwhile, Toys "R" Us took its market power in the specialized-discount-toy-store segment and leveraged it to force toy manufacturers to offer inferior "bundles" of toys to warehouse clubs, thereby protecting Toys "R" Us's preexisting monopoly in its own segment. *See* 221 F.3d at 931-32. Nothing comparable happened here. Apple simply *entered* a market it never competed in, using bargained-for agreements that did not set prices or limit output at all.[2]

It is also not true, as Plaintiffs argue, that the "economic context made it clear that all

[2] Apple's commonsense negotiating tactics are a far cry from Interstate Circuit's "letter openly addressed to all eight major national film distributors" or Toys "R" Us's willingness to carry "the message 'I'll stop if they stop' from supplier to supplier and acting as a clearinghouse about 'breaches' by co-conspirators." Opp. at 19-20.

[Publishers] . . . needed to act uniformly or all would lose business." Opp. at 19. There is nothing about this case that presents a "must deal" situation: If some publishers agreed with Apple and others did not (like Random House, ¶ 170), then those who agreed could compete for sales through both Apple and Amazon distribution platforms, while competing against others selling only through Amazon (and the other distributors like Barnes & Noble).[3] But if a publisher did not sign up with Apple, it suffered no collateral consequences. The publisher had no relationship with Apple in the first place, and neither party was worse off than before. Calling Apple "'the most powerful digital content distribution company'" (¶ 112) is meaningless rhetoric. Plaintiffs say nothing about Apple's position in the alleged relevant market, eBooks, and do not establish the required "must deal" dynamic that is at the core of the hub and spoke cases Plaintiffs rely on – *Interstate Circuit* and *Toys "R" Us*. Nor do they refute the many authorities that make clear that a "hub" is the "dominant purchaser or supplier in the relevant market."[4] Thus, Apple's lack of market power is fatal to any analogy to these cases: The movie distributors and the toy companies were damned if they agreed to raise prices or stop selling unless everyone else did, and damned if they didn't agree because Interstate Circuit or Toys "R" Us would stop dealing with them. No such choice was presented by Apple

Plaintiffs claim they "take no issue with Apple's decision to begin retailing eBooks or to contract with leading publishers, nor with the Publisher Defendants' decision to contract with

[3] Plaintiffs' contention that Apple needed unanimity because otherwise, it "would be a distributor with higher prices entering a market against an established competitor with lower prices and likely no sales for eBooks" (Opp. at 33), relies impermissibly on a host of "bald assertion[s]" in the Complaint "without any supporting allegations." *In re Citigroup ERISA Litig.*, 662 F.3d 128, 141 (2d Cir. 2011). Plaintiffs' contention also ignores that Apple, as an agent on commission and with an MFN that allowed it to require price matching on individual titles, could profit from selling eBooks even at Amazon's pre-entry prices. Apple also retained the option of not launching the iBookstore, since the iPad had a host of other functions marketed to consumers, including web-browsing, email, videos, viewing photos, and listening to music.

[4] *See, e.g.*, *Howard Hess Dental Labs. Inc. v. Dentsply, Int'l, Inc.*, 602 F.3d 237, 255 (3d Cir. 2010); *Total Benefits Planning Agency, Inc. v. Anthem Blue Cross & Blue Shield*, 552 F.3d 430, 435 n.3 (6th Cir. 2008); 2 P. Areeda & H. Hovenkamp, *Antitrust Law: An Analysis of Antitrust Principles* at 188 n.11 (2d ed. 2000).

Apple." Opp. at 52. But then it is hard to see what remains. Plaintiffs cite a laundry list of supposed "plus factors" (Opp. at 23-36) most of which do not pertain to Apple, or are addressed elsewhere in this brief, or simply are not probative at all of a conspiracy.[5] And as described above, Plaintiffs' reliance on *Interstate Circuit* and *Toys "R" Us* is misplaced; Apple was not a dominant "hub" masterminding a horizontal price fixing conspiracy for its benefit, offering terms its suppliers did not want, but would acquiesce in so long as everyone else did. Instead, Apple recognized an opportunity, in a context where it was public knowledge that publishers were unhappy with the strategies of the "dominant" incumbent distributor, to offer an attractive additional option which many, but not all, took. "[T]here is no reason to infer that the companies had agreed among themselves to do what was only natural anyway." *Twombly*, 550 U.S. at 566.

II. There Is No Allegation that Apple Had Any Involvement in the Critical Step in Plaintiffs' Conspiracy Theory – "Forcing" Amazon to Raise Prices

Plaintiffs allege that forcing Amazon to raise eBook prices was *the* alleged conspiracy's terminal goal. But there are *no allegations* that Apple had any dealings with Amazon in its eBook business, or anything to do with the Publishers' windowing threats, which began before Apple approached the Publishers. Nor are there allegations that Apple had any input into how the Publishers later negotiated with Amazon – which, in fact, occurred *after* Apple was already locked into agency agreements. For Plaintiffs to allege broadly that "Apple conspired with the Publisher[s]" to "cut into Amazon's substantial share of the [eBooks] markets" (¶ 184) is insufficient because "under *Iqbal* and *Twombly*," a plaintiff cannot rely "on conclusory allegations to

[5] Of those even arguably pertaining to Apple, Steve Jobs's quotes are addressed at pp. 10-11, Apple's alleged motives to conspire are addressed at pp. 11-12, Apple's alleged need for unanimity among the Publishers is addressed at pp. 6-8, the alleged rise of eBook prices is addressed at pp. 14-15, and the relationship of eBook prices to costs is addressed at p. 15 n.11. As for market concentration, the Supreme Court has explained that "[e]ven in a concentrated market, the occurrence of a price increase does not in itself permit a rational inference of conscious parallelism or supracompetitive pricing." *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 237 (1993). The Second Circuit's case, *Starr v. Sony BMG Music Entertainment*, 592 F.3d 314 (2d Cir. 2010), which Plaintiffs draw their "plus factors" from, is inapplicable here for reasons Apple has already provided and Plaintiffs fail to address substantively. *See* Apple MTD at 18-20.

fill the gaps in his complaint." *Plair v. City of N.Y.*, 789 F. Supp. 2d 459, 470 (S.D.N.Y. 2011).

Instead of *facts* to support their claim that Apple conspired to force Amazon to change its eBook business model, Plaintiffs place utmost reliance upon their reading of two of Steve Jobs's statements to the press. These statements about Amazon business strategy – namely, that "Amazon screwed it up" by paying "the wholesale price for some books, but [then] selling them below cost at $9.99" and that "Publishers are actually withholding their books from Amazon because they're not happy" and would continue to do so after Apple entered into the agency agreements (¶¶ 17, 18) – on their face reflect Jobs's view from publicly known facts that Amazon's business strategy was a mistake that Apple would not follow. These are facts that Apple was entitled to take into account as part of its "rational and competitive business strategy" (*Twombly*, 550 U.S. at 554), and when a CEO offers a sober assessment of business realities, that hardly suggests a conspiracy. *See id.* at 569 n.13 (no plausible conspiracy where CEO acknowledged that competing "'might be a good way to turn a quick dollar,'" but also said that the preexisting pricing model is "'just . . . nuts'" and "would not be 'a sustainable economic model'"). There is nothing about Jobs's quoted view of the market that admitted a conspiracy or alleged facts that make a conspiracy plausible. Indeed, the statements describe business conflicts between suppliers and the dominant distributor, Amazon, which gave Apple opportunities as a new entrant to earn money as an agent for parties that were interested in having access to direct distribution.

Further, Jobs's excerpted statements that "prices will be the same" after Apple's entry (¶ 17) and that Apple told the publishers, "yes, the customer pays a little more, but that's what you want anyway" (¶ 18) are not admissions of a horizontal conspiracy to the mass media, but rather just basic economic predictions. That competing publishers, who once converged upon similar prices under one business model, would be expected to do so under another model is the

essence of behavior in a *competitive* market, not the hallmark of a conspiracy. And an agent's acknowledgment of its principal's desire to set an above-cost retail price also reflects basic economic realities. Regardless, even stitching Jobs's statements together into a "prediction" of equal pricing at a "little" higher level does not make out a plausible conspiracy, for it cannot logically be maintained that "[a]bsent Apple's knowledge of and participation in the unlawful conspiracy, Steve Jobs would not have been able to predict [higher prices] with such startling accuracy." ¶ 135. A coin flip alone would have guaranteed a 50% chance of attaining "such startling accuracy." That one of the most widely acclaimed business minds of the twenty-first century was able to improve on a coin flip should not be taken seriously as a plausible sign of unlawful conspiracy. It was no secret that individual publishers felt eBooks were not properly priced by Amazon. It was a fair bet that consumers may pay a little more if publishers were able to set their own prices for their own products. That "prices would be the same," high or low, is a basic prediction of economics – not the springboard for a plausible inference that "Defendants had constructed a scheme to ensure consumer prices for eBooks would go up and standardize at these higher price levels." Opp. at 26. Plaintiffs cannot rely on these "'unwarranted deductions of fact'" to escape dismissal. *Lentell v. Merrill Lynch & Co.*, 396 F.3d 161, 175 (2d Cir. 2005).

Plaintiffs' final attempt to link Apple to Amazon's higher prices is with a shifting theory of *why* Apple allegedly wanted to conspire.[6] After Apple pointed out it was irrational for Plaintiffs to allege that Apple wanted to protect the pricing of physical books it did not sell, or wanted

[6] While Plaintiffs do not seem to dispute that Apple is in a far different position than the Publishers and that they must plausibly plead Apple's individual agreement to a conspiracy, Plaintiffs nonetheless shrink from their obligations by claiming that "conspiracy allegations 'need not be detailed on a defendant by defendant' basis." Opp. at 49. But that is not true. "[A]n antitrust plaintiff must present evidence tending to show that association members, in their individual capacities, consciously committed themselves to a common scheme designed to achieve an unlawful objective." *AD/SAT v. Associated Press*, 181 F.3d 216, 234 (2d Cir. 1999). At a bare minimum, alleged coconspirators' acts cannot be attributed to Apple unless Apple's membership in the purported conspiracy is plausibly alleged to begin with. Yet Plaintiffs' labored contrivance of supposed Apple motives to harm Amazon is but one sign of an absence of any plausible common cause to conspire in the first place.

to "'*slow*" the very eBook segment it stood to profit from (Apple MTD at 1 (quoting ¶ 77)), Plaintiffs have unceremoniously abandoned those theories in favor of claiming that "Defendants' scheme was *to raise eBook prices and restrain Amazon's competitive advantage in eBook sales*" (Opp. at 13). Reliance on "general proposition[s]" is insufficient, for "[o]nly if such factual support exists, can [plaintiffs] nudge [their] alleged injury from one that is conceivable to one that is plausible." *Amidax Trading Group v. S.W.I.F.T. SCRL*, 671 F.3d 140, 146 (2d Cir. 2011).

Plaintiffs' allegations on Apple's alleged competitive interests to conspire – chiefly revolving around Apple's unspecified "belief" that "it was necessary to enter the eBooks market [because] Kindle [w]as a long-term threat to its dominant position" (¶ 117) – are pulled-from-thin-air "bald assertion[s], without any supporting allegations," which lack logical force to boot, since the Kindle was then an eReader and the iPad was a revolutionary multi-use device. *In re Citigroup ERISA Litig.*, 662 F.3d at 141. Moreover, Apple offered the Kindle App on the iPad (¶ 140), a sign that Apple hardly suffered from a fear of competition and a fact that puts the lie to Plaintiffs' claim that Apple needed to conspire "to knock out a reason to buy a Kindle versus an iPad – the price of eBooks" (Opp. at 32), as both eBook distributors were potentially available for iPad owners to choose between. Plaintiffs' conspiracy, as pleaded, turns on concerted horizontal action forcing Amazon to raise prices – and yet there are no allegations that Apple had any involvement in this, nor any plausible factual allegations that Apple needed to harm Amazon's ability to compete on price through a complex horizontal hub and spoke conspiracy to enter the eBooks market as an agent. This is not mere "competing inferences," but a deficient complaint that should be dismissed as to Apple.

III. Plaintiffs Still Fail to Plead an Unlawful Restraint of Trade by Apple Even Assuming *Arguendo* the Existence of a Conspiracy

Plaintiffs do not plead that Apple's agency agreements constituted an unlawful restraint

of trade. Plaintiffs assert that Apple's alleged "role in facilitating" supposed price fixing by the Publisher Defendants warrants *per se* liability (Opp. at 51), but this is wrong even assuming *arguendo* the existence of a publisher conspiracy. In the first place, Plaintiffs neglect the Complaint's allegation that Apple is a genuine *agent* of each publisher, which means that any agreements on price with Apple would be *lawful*. *See* Apple MTD at 1, 20; *Morrison*, 797 F.2d at 1437 ("[N]or can it seriously be argued that the ancient and ubiquitous practice of principals' telling their agents what price to charge the consumer is just some massive evasion of the rule against price fixing."). Moreover, Apple's role in any "price fixing" would be a *vertical* one governed (at worst) by the rule of reason. *See Leegin Creative Leather Prods., Inc. v. PSKS, Inc.,* 551 U.S. 877 (2007). Acknowledging the Supreme Court's *express* statement that the rule of reason applies even when a vertical agreement is "entered upon to facilitate" a horizontal price-fixing "cartel" (*id.* at 893), Plaintiffs confess such an allegation "technically comes under the rubric of the rule of reason," only to argue that the Supreme Court really intended for such treatment to be an empty gesture masking a policy of automatic condemnation (Opp. at 52). The lower courts, however, have not presumed the Supreme Court meant to apply the *per se* rule in the guise of the rule of reason, and have read *Leegin* to call for normal rule of reason analysis.[7]

But Plaintiffs fail to state a rule of reason claim. *Leegin* makes clear that market power is a critical factor under the rule of reason. *See* 551 U.S. at 898 (abuse of "resale price maintenance for anticompetitive purposes may not be a serious concern unless the relevant entity has market power"); *PSKS, Inc. v. Leegin Creative Leather Prods, Inc.*, 615 F.3d 412, 418-19 (5th Cir. 2010) ("To allege a [post-*Leegin*] vertical restraint claim sufficiently, a plaintiff must plausibly allege the defendant's market power."). Plaintiffs concede, however, that Apple "*lack[ed]*

[7] *See, e.g., Toledo Mack Sales & Serv., Inc. v. Mack Trucks, Inc.*, 530 F.3d 204, 225 (3d Cir. 2008); *MYD Marine Distrib., Inc. v. Int'l Paint Ltd.,* 76 So. 3d 42, 48-49 (Fla. Dist. Ct. App. 2011).

market power" in the alleged relevant market, a concession compelled by Apple's lack of market share and the fact that its competitor was a *monopolist*. Opp. at 54 (emphasis added). Plaintiffs cannot dismiss this as "irrelevant."[8] *Id*. The Supreme Court has never found a violation of the rule of reason by a party whose lack of market power was an *undisputed fact*.[9] Apple's lack of such power means it has *no* "ability to raise prices above those that would be charged in a competitive market." *Nat'l Collegiate Athletic Ass'n*, 468 U.S. at 109 n.38.

Plaintiffs contend nonetheless that they can plead a rule of reason claim against Apple merely by making an "allegation that prices have increased." Opp. at 53. This is insufficient for multiple reasons. First, in *Leegin,* the Supreme Court *rejected* inferring anticompetitive harm on the basis that vertical pricing agreements "can lead to higher prices," holding that mere reliance on pricing effects is "mistaken." 551 U.S. at 895. Indeed, the Court specifically noted the capacity of higher prices to "increase interbrand competition by facilitating entry for new firms and brands," something the Court labeled "essential to a dynamic economy" and "procompetitive." *Id*. at 891 ("if markets can be penetrated by using resale price maintenance there is a procompetitive effect"). Second, even restricting attention solely to pricing effects, Plaintiffs must offer concrete allegations that market prices have risen to *supra*-competitive levels ("above those that would be charged in a competitive market"), which Plaintiffs fail to do save for in

[8] Plaintiffs argue they can press a rule of reason claim *against Apple* by *ignoring* Apple's lack of power and relying on purported publisher market power. Opp. at 54. Not so. Post-*Leegin* cases have evaluated the market power of the *vertical* defendant: *Toledo Mack,* 530 F.3d at 226 (addressing proof of market power of manufacturer, not conspiring dealers); *MYD Marine Distrib.,* 76 So.3d at 49 (same).

[9] In *National Collegiate Athletic Ass'n v. Board of Regents of Univ. of Okla.*, 468 U.S. 85 (1984), the Court stated that "the absence of proof of market power does not justify a naked restriction on price or output" but proceeded to hold that "[a]s a factual matter, it is evident that petitioner does possess market power." *Id.* at 109, 111. In *FTC v. Ind. Fed'n of Dentists*, 476 U.S. 447 (1986), the Court doubted that the horizontal agreement (to withhold a service) under review there was "sufficiently 'naked' to call this principle into play," and held only that in the absence of any procompetitive effects a "failure to engage in *detailed market analysis* is not fatal." *Id*. at 460 (emphasis added). As the Seventh Circuit has explained, "these cases stand for the proposition that if a plaintiff can show the rough contours of a relevant market, and show that the defendant commands a substantial share of the market, then direct evidence of anticompetitive effects can establish the defendant's market power—in lieu of the usual showing of a precisely defined relevant market and a monopoly market share." *Republic Tobacco v. N. Atl. Trading Co.*, 381 F.3d 717, 736 (7th Cir. 2004) (footnote omitted).

conclusory terms. *See* Apple MTD at 22-24; *E.I. DuPont de Nemours & Co. v. FTC*, 729 F.2d 128, 139 (2d Cir. 1984) ("Labeling prices as 'supracompetitive'" "hardly converts [the] pricing into an 'unfair' method of competition."). Nor have Plaintiffs plausibly alleged that Amazon's below-cost pricing model constituted the *competitive* level in the eBook market *after* Amazon's "dominance" was challenged by Apple's entry.[10] *See, e.g.*, *Jacobs v. Tempur-Pedic Int'l, Inc.*, 626 F.3d 1327, 1339 (11th Cir. 2010) ("beyond the bald statement that consumers lost hundreds of millions of dollars, there is nothing establishing the competitive level above which TPX's allegedly anticompetitive conduct artificially raised prices"). Third, price *cannot be divorced from output*, legally or economically, and it is beyond dispute that Apple's entry with the iPad and iBookstore was expected to, and did, "prompt a surge in eBook purchasing."[11] ¶ 156. Higher output is a *procompetitive* effect, and as the Supreme Court has held, "a price increase does not in itself permit a rational inference of . . . supracompetitive pricing" when "output is expanding at the same time prices are increasing." *Brooke Group*, 509 U.S. at 237.

In sum, Plaintiffs have not made out a plausible case against Apple under the rule of reason. They pay lip service to "tak[ing] no issue with Apple's [procompetitive] decision to begin retailing eBooks or to contract with leading publishers" (Opp. at 52), but in reality they offer a Hobson's choice: Apple was not free to "depart[] from centuries old practice to adopt the agency model of pricing," even though (on their own view) "[w]ithout it, Apple had little chance of

[10] Plaintiffs unblushingly argue that "there has been no increase in costs to justify these [post-entry] higher prices" and that the prices were "completely untethered to a discernable cost increase" (Opp. at 28), while at the same time embracing $9.99 pricing that was not just untethered to but actually *below* cost. Strangely, Plaintiffs assert that "Apple does not know at this stage whether or not Amazon was indeed pricing below cost" (Opp. at 46), overlooking that *Plaintiffs themselves* plead below-cost pricing. Plaintiffs' rejection of "static pricing" assumptions and their speculative musings about what "might" or "may" have happened to prices and profits (Opp. at 46-47), further confirm their failure to plead anticompetitive effects from Apple's conduct.

[11] Plaintiffs cannot and do not allege that *market output* of eBooks has been reduced by Apple's entry through agency agreements. Recognizing this, Plaintiffs admit that output grew but that the *rate* of growth "slowed after adopting the Agency model compared to the growth rate of eBook sales for publishers still selling titles under the wholesale ('reseller') model." ¶ 88; *see also* Opp. at 29. But even this contention is risible. Plaintiffs have indexed *sales on Amazon only*. ¶ 88. The supposed "slower" growth rate is a function of *ignoring* agency sales through the iBookstore (and other non-Amazon platforms). Plaintiffs cannot ignore inconvenient data.

succeeding in the eBook market." Opp. at 30, 39. "Yet if law sweepingly declares off-limits business methods that companies might opt to use for legitimate commercial reasons, consumers – the intended beneficiaries of antitrust law – are worse off." *Valuepest.com of Charlotte, Inc. v. Bayer Corp.*, 561 F.3d 282, 294 (4th Cir. 2009) (upholding lawfulness of agency agreements). Under the rule of reason, Apple, a party concededly without market power, cannot be condemned for making choices that were reasonable in the circumstances, that were consistent with its past business practices, that enabled entry, market growth and product choice, and that entailed competitive pricing by every normal economic measure.

IV. Plaintiffs' State-Law Claims Still Fail

Plaintiffs do not dispute that their state antitrust and unjust-enrichment claims turn on pleading a Sherman Act violation, which they do not. Opp. at 55-56. Plaintiffs' state antitrust claims additionally fail because they are brought under an indirect-purchaser theory, yet Plaintiffs plead they are direct purchasers as to Apple, and they plead no basis on which *Illinois Brick* would bar their action notwithstanding Plaintiffs' citation to irrelevant cases dealing broadly with coconspirator liability (Opp. at 56 n.160).

CONCLUSION

The Consolidated Amended Class Action Complaint should be dismissed as to Apple.

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Respectfully submitted,

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