Apple Found to Have Orchestrated Conspiracy to Fix E-Book Prices

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Apple Inc. played a central role in facilitating and executing a conspiracy among publishers to fix retail prices for electronic books, or e-books, the federal district court in New York City decided last week. The finding of liability against Apple comes after a bench trial that lasted from June 3 to June 20 in an action brought by the U.S. Department of Justice and 33 states and territories.

In April 2012, the Department of Justice Antitrust Division and a number of state attorneys general brought actions against Apple and leading publishers for conspiring to fix the sales prices of e-books. The suits named as defendants Apple and publishers Hachette Book Group (USA), HarperCollins Publishers L.L.C., Simon & Schuster Inc., Holtzbrinck Publishers LLC, which does business as Macmillan, and Penguin Group (USA). The case went to trial against Apple only, as all five of the publishers settled the federal and state charges.

The court ruled that the plaintiffs proved their case against Apple "through compelling direct and circumstantial evidence." In reaching its conclusion, the court noted its heavy reliance on the documentary record. Although the court heard testimony from executives at Apple and the five publishers, these witnesses were "less than forthcoming," the court noted. Thus, the court looked to "the contemporaneous documentary record [which] was replete with admissions about their scheme." The court pointed to admissions by Apple founder Steve Jobs, as well as e-mails and phone calls.

Apple undertook to orchestrate the conspiracy as it prepared for the 2010 launch of its new iPad tablet device and its iBookstore, according to the court. Already at that time, the publishers were opposed to the $9.99 e-book pricing strategy utilized by Amazon, which is the market leader in the sale of e-books and e-book readers.

“With a full appreciation of each other’s interests, Apple and the Publisher Defendants agreed to work together to eliminate retail price competition in the e-book market and raise the price of e-books above $9.99,” the court explained.

As a result of Apple’s efforts, the industry moved from a wholesale model—where a publisher receives its designated wholesale price for each e-book and the retailer sets the retail price—to an agency model, where a publisher sets the retail price and the retailer sells the e-book as its agent, according to the court. The agency agreements that Apple and the publishers executed also included a price parity provision, or Most-Favored-Nation clause (MFN). The MFN permitted Apple to match the lowest retail price listed on any competitor’s e-bookstore and imposed a penalty upon a publisher if it did not force Amazon and other retailers to switch to the agency model. The publishers forced Amazon to relinquish retail pricing authority and to move to an agency arrangement.

The court noted, however, that it was not holding that the agency model for distribution of content, or any one of the clauses included in the agreements, or any of the identified negotiation tactics was inherently illegal. Based on the totality of the evidence, Apple’s conduct was illegal.

Apple directly participated in a horizontal price-fixing conspiracy, the court ruled. As a result, its conduct was *per se* unlawful. However, the court noted that, even if it were necessary to analyze the evidence under the rule of reason, the plaintiffs would also prevail. Apple did not show that the agreements had any pro-competitive effects.

There was circumstantial evidence of a conspiracy, the court ruled. This evidence included, among other things, the goal of each publisher to raise the $9.99 price point to protect its physical book business; the “abrupt shift” to the agency model for the distribution of e-books; and actions of the publishers against their near-term financial interests in adopting a model that deprived each of them of a stream of expected revenue from the sale of e-books on the wholesale model.

The court pointed to a quote from Steve Jobs to a reporter, confirming that e-book prices in the iBookstore and at Amazon "will be the same," and that the "Publishers are actually withholding their books from Amazon because they are not happy."

The court explained that consumers suffered from the scheme to eliminate retail price competition. Some consumers had to pay more for e-books, while others bought a cheaper e-book or deferred a purchase altogether. In addition, the publishers, in control of pricing, were less willing to authorize retailers to give consumers the benefit of promotions, according to the court.

The court rejected each of the arguments that Apple presented in its defense. Most notably, the court concluded that the evidence "overwhelmingly demonstrates" that Apple did not act independently. It also refused to accept Apple's "counter-narrative of the events that transpired in December 2009 and January 2010." Apple also failed to convince the court that a ruling against it would "deter entry into concentrated markets and punish innovation."

The court also rejected Apple's argument that the opening of the iBookstore actually led to an overall decline in trade e-book prices during the two-year period that followed that event. The evidence was not persuasive, in the court's view.

At a later date, the court will consider the plaintiffs' request for injunctive relief and damages.

Department of Justice Statement

Calling the decision "a victory for millions of consumers who choose to read books electronically," William Baer, Assistant Attorney General in charge of the Department of Justice's Antitrust Division, warned in a statement that "[c]ompanies cannot ignore the antitrust laws when they believe it is in their economic self-interest to do so."

A spokesman for Apple has said that the company intends to appeal the decision.

The July 10, 2013, decision, U.S. v. Apple Inc., is published at 2013-2 Trade Cases ¶78,447.