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ANTITRUST LAW

Price Fixing by Apple and Book Publishers — What About Amazon?

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There's an old joke about a vendor who sells apples from his cart for eight cents when his competitors sell them for 10 cents per apple. When asked how much he pays for each apple he sells, he says "nine cents." When asked how he can make a living doing that, he proudly yells "VOLUME."

Amazon, apparently, is a devotee of the apple vendor's business plan. It recently announced quarterly sales of $19.36 billion—certainly an impressive volume—but losses of $126 million.

Fortunately for Amazon, unlike the apple vendor, it has investors who are willing to bear those losses while it builds market share. They will, however, eventually demand that Amazon reward their loyalty and patience with profit.

That's what predatory pricing is all about; a market participant lowers prices below its cost, gains substantial, perhaps monopolistic, market share and then raises its prices to supra-competitive levels. See, e.g., *William Inglis v. ITT Continental Baking Co*., 668 F.2d. 1014, 1035 (9th Cir. 1981).

According to the District Court that held Apple liable for its violation of the Sherman Act, Amazon purchased e-books for $13.99 and sold them for $9.99. In doing so it captured 90 percent of the e-book market.

To date, Amazon has maintained its $9.99 price for most e-books. Indeed, it recently (before revealing its quarterly results) announced a program whereby a consumer can download to a Kindle an unlimited number of a wide variety of e-books for a flat $9.99 monthly fee. Perhaps Amazon expects to make up its book losses through increased Kindle sales.

Amazon recently defended its pricing policies in a *Publishers Weekly* article, echoing the apple vendor, that its low prices increase the volume of book sales.

That position is likely true, but what are those prices doing to the publishing industry? As a result of its market power and its seeming invincibility—after all, it was Apple and the publishers who tried to defend their industry from Amazon who were punished by the federal courts, not Amazon—Amazon has been demanding concessions from the publishers, punishing those who fail to succumb to its demands. It has, accordingly, refused pre-orders from Hachette and under-stocked its hardcover books.

Amazon's volume argument fails to account for the publishers' costs. While e-book costs may be lower than hardcover books, i.e., there's no printing and no returns, there is still direct and indirect overhead. There are still author royalties, editorial costs, copy editing, rent, utilities, legal, insurance, etc. Amazon, without regard for those costs, picked a price point and is demanding that publishers reduce their wholesale prices accordingly.

What Amazon also has done

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through its pricing program is to devalue hardcover books. Who is going to pay $20–$25 for a hardcover book when that same title may be purchased as an e-book for $9.99?

Assuming the federal court's findings of fact are accepted, then Apple, no doubt, engaged in a horizontal price-fixing conspiracy with five publishers. Apple participated with, and, indeed, induced the publishers to adopt an agency marketing program designed to increase e-book prices.

In a vacuum, it's a textbook per se violation of Section 1 of the Sherman Act. It didn't matter to Federal District Court Judge Denise Cote that the whole conspiracy was brought about in reaction to Amazon's predatory conduct. As Judge Cote said:

> This trial has not been the occasion to decide whether Amazon's choice to sell NYT Bestsellers or other New Releases as loss leaders was an unfair trade practice or in any other way a violation of law. …Another company's violation of antitrust laws is not an excuse for engaging in your own violations of law.

Yet, by not being concerned with the cause of Apple's and the publishers' conduct—and by leaving Amazon in its current position as market bully—did the court carry out the intent of the antitrust laws?

As the Supreme Court has said: "[A] ntitrust analysis must always be attuned to the particular structure and circumstances of the industry at issue." *Verizon Communications v. Law Offices of Curtis V. Trinko*, 540 U.S. 398, 411 (2004).

How can an analysis of pricing in the publishing industry not take Amazon's conduct into account?

The genius of the Sherman Act is its flexibility and adaptability. In that way, it is similar to the Constitution of the United States. Although the Sherman Act was enacted in reaction to large industrial trusts that came about following the Civil War, it is neither strictly a solution to the problems of the late 19th century any more than the Constitution was meant to deal with the agrarian society of the late 18th century.

That flexibility and adaptability has resulted in changes in judicial determinations of what is or is not automatically considered an unreasonable restraint of trade.

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While, historically, price fixing among competitors was, and remains a per se violation of the Sherman Act—meaning it is conduct deemed unlawful without market analysis—that does not mean a court is to review the facts with blinders.

At one time there were several offenses deemed to be per se violations of the Sherman Act. In addition to horizontal price fixing, per se violations included vertical price fixing, both for minimum and maximum prices, horizontal and vertical allocations of territories, tie-in arrangements and refusals to deal and group boycotts. See, e.g., *Northern Pacific Railway Co. v. United States*, 356 U.S. 1 (1958).

One by one, per se treatment of the offenses gave way to determinations by the Supreme Court that, perhaps, instead of assuming that an offense has injured competition in the market, an analysis should be made in each case as to whether that injury actually occurred. The only way to do that is to look at the market as a whole, not just isolated conduct within that market.

There has even been some backtracking regarding the hard-and-fast rule that horizontal price fixing is automatically deemed an antitrust violation. Thus, for example, in *Broadcast Music v. Columbia Broadcasting System*, 441 U.S. 1 (1979), a blanket license agreement which allowed composers to fix prices, was deemed not to be a per se Sherman Act violation. In issuing its ruling, the court remarked that "easy labels do not always supply ready answers," and that even when a practice appeared to be a traditional per se violation, courts should still determine "whether the practice facially appears to be one that would always or almost always tend to restrict competition and decrease output…or instead [is] one designed to increase economic efficiency and render markets more, rather than less, competitive."

Is the book publishing market more efficient, more competitive, if Amazon is in a position as a monopsonist to bully publishers into making concessions solely to it? Is the market more efficient, more competitive if hardcover books are devalued? Will enforced price cutting ultimately reduce, or, perhaps, eliminate the editorial function served by publishers, with the resultant reduction of quality? Should quality have any role in the analysis or are books to be treated like widgets, completely interchangeable consumer goods?

Those are just a few of the questions that need to be asked and answered. Because the district court focused solely on Apple's activities with the publishers, and ignored Amazon's conduct, those questions were not asked or considered. It is submitted that they should have been, and it is hoped that the Court of Appeals will require it.■