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A New Chapter in Antitrust Law: The Second Circuit's Decision in *United States v. Apple* Determines Hub-and-Spoke Conspiracy Per Se Illegal

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A NEW CHAPTER IN ANTITRUST LAW: THE SECOND CIRCUIT'S DECISION IN *UNITED STATES v. APPLE* DETERMINES HUB-AND-SPOKE CONSPIRACY PER SE ILLEGAL

Abstract: On June 30, 2015, in *United States v. Apple, Inc.*, the U.S. Court of Appeals for the Second Circuit held that Apple's agreements with five publishing companies violated the Sherman Act. With Apple as a retailer and the publishers as manufacturers, the agreements between the two groups were vertical. This classification is significant because in 2007 in *Leegin Creative Leather Products v. PSKS, Inc.*, the Supreme Court held that all vertical agreements should be analyzed under the rule of reason. Rather than looking at the structure of the agreements, however, the Second Circuit focused on the type of market restraint that the agreements imposed. Because the vertical agreements facilitated a horizontal conspiracy to raise and set ebook prices, the court reasoned that the agreements were per se illegal. This Comment argues that the Second Circuit erred in finding that the agreements were per se illegal. By ignoring the rule of reason analysis, the Second Circuit's holding prevented Apple from demonstrating the procompetitive justifications for its agreements.

INTRODUCTION

Section 1 of the Sherman Act, the bedrock of antitrust law, prohibits any contracts, combinations, or conspiracies that unreasonably restrain trade.[1] The Sherman Act aims to protect interbrand competition, as this unrestrained competition will result in higher quality products and lower prices for consumers

[1] Sherman Act § 1, 15 U.S.C. § 1 (2012); *see* United States v. Topco Assocs., Inc., 405 U.S. 596, 610 (1972) (holding that the Sherman Act is the "Magna Carta of free enterprise"); *see also* Tekton, Inc. v. Builders Bid Serv. of Utah, Inc., 676 F.2d 1352, 1354 (10th Cir. 1982) (holding that only those conspiracies that unreasonably restrict competition are considered unlawful). Though the Sherman Act literally prohibits any restraints of trade, this has been modified to prohibit only unreasonable restraints that affect competition. Sherman Act § 1; *see* Nat'l Collegiate Athletic Ass'n v. Bd. of Regents of Univ. of Okla., 468 U.S. 85, 103–04 (1984) (noting that Sherman Act focuses on the restraint's effect on competition); *see also* State Oil Co. v. Khan, 522 U.S. 3, 10 (1997) (explaining that despite Sherman Act's inclusion of all restraints of trade, common law has subsequently limited this prohibition to just unreasonable restraints). Such unreasonable restraints, occurring between two or more parties, include raising and fixing prices and group boycotts. *See* Arizona v. Maricopa Cnty. Med. Soc'y, 457 U.S. 332, 351 (1982) (explaining that price fixing agreements are per se unlawful regardless of any procompetitive effects); Klor's, Inc. v. Broadway-Hale Stores, Inc., 359 U.S. 207, 212 (1959) (noting that group boycotts are per se unlawful restraints on trade); Rossi v. Standard Roofing, Inc. 156 F.3d 452, 465 (3d Cir. 1998) (showing that Sherman Act violation depends on concerted, rather than unilateral, action among two or more parties).

but will also maintain democratic ideals.[2] There are generally two ways to address an alleged Sherman Act violation: per se illegality and rule of reason analysis.[3] How to assess whether a restraint is unreasonable to the point of per se illegality or whether it demands further market inquiry, however, has become increasingly difficult over the last century.[4]

As a new participant in the ebook industry, Apple allegedly violated the Sherman Act through its contracts with five main publishing companies.[5] In 2010, Apple included an iBookstore app on its iPad to rival Amazon's Kindle in the ebook industry.[6] Given that Amazon maintained 90% of the ebook retailer market at the time, Apple needed to negotiate with the publishers to ensure that it could feasibly compete.[7] Apple agreed to eliminate Amazon's $9.99 price standard by adopting an agency model contract that included price caps

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[2] *Khan*, 522 U.S. at 15; N. Pac. R.R. Co. v. United States, 356 U.S. 1, 4 (1958). One of the fears that Congress intended to address through the Sherman Act was the possibility that the concentration of economic power among private parties would cause "antidemocratic political pressure." Robert Pitofsky, *The Political Content of Antitrust*, 127 U. PA. L. REV. 1051, 1051 (1979); *see also* Thomas A. Lambert, *The Roberts Court and the Limits of Antitrust*, 52 B.C. L. REV. 871, 874–75 (2011) (noting that, because principle goal of antitrust legislation is to maximize competition, antitrust regulates monopolies and collusion among competing entities in the market).

[3] *See* Nat'l Soc. of Prof'l Eng'rs v. United States, 435 U.S. 679, 692 (1978) (noting that per se illegality and rule of reason analysis designed to assess the restraints' impact on competition); *In re* Ins. Brokerage Antitrust Litig., 618 F.3d 300, 315–17 (3d Cir. 2010) (showing that despite rule of reason being the primary standard for analyzing unreasonable restraints on trade, per se illegality used for those agreements that have been deemed to have few procompetitive justifications).

[4] *See* Cal. Dental Ass'n v. Fed. Trade Comm'n, 526 U.S. 756, 779–81 (1999) (noting that because there is no bright line between unreasonable restraints that should be per se illegal and those that should receive rule of reason treatment, the applicable analysis changes with both circumstances and time); Cont'l Airlines, Inc. v. United Airlines, Inc., 277 F.3d 499, 508–09 (4th Cir. 2002) (noting that the division between rule of reason analysis and per se illegality is not rigid but instead exists on a spectrum); *see also* Thomas Piraino, *Making Sense of the Rule of Reason: A New Standard for Section 1 of the Sherman Act*, 47 VAND. L. REV. 1753, 1771 (1994) (suggesting that the federal court should abandon the per se rule and rule of reason and adopt a three-part continuum to assess the restraints' impact on the market).

[5] United States v. Apple, Inc. (*Apple II*), 791 F.3d 290, 296, 311 (2d Cir. 2015), *cert. denied*, No. 15-565, 2016 WL 854227 (Mar. 7, 2016) (mem.).

[6] *See id.* at 301 (describing the launch of the iBookstore app). Amazon, one of the largest retailers on the Internet, released the Kindle in 2007. *Id.* at 299; *see* Kathleen Sharp, *Amazon's Bogus Anti-Apple Crusade*, SALON (Jan. 12, 2014), http://www.salon.com/2014/01/12/amazons_bogus_anti_apple_crusade/ [https://perma.cc/Y6WK-CCBB] (explaining that Amazon, one of the world's largest technology companies and retailers, set its ebook prices at $9.99 to induce consumers to buy the Kindle). As the second portable electronic device on the ebook market, Amazon's Kindle enabled users to buy, download, and read ebooks. *Apple II*, 791 F.3d at 299. Similarly, the iBookstore app on the iPad functioned as an ebook marketplace, in which readers could buy, download, and read ebooks. *Id.* at 301.

[7] *Apple II*, 791 F.3d at 301–02; *see also* Rory Maher, *Here's Why Amazon Will Win the eBook War: Kindle Already Has 90% eBook Market Share*, BUS. INSIDER (Jan. 13, 2010), http://www.businessinsider.com/amazon-selling-90-of-all-e-books-2010-1 [https://perma.cc/B42U-5LE9] (noting that as of 2010, Amazon sold 90% of all ebooks, making the Kindle the standard ebook format).

and a Most-Favored-Nations ("MFN") clause.[8] With the combination of the agency model, price caps, and the MFN clause, Apple's contracts with publishers resulted in raised prices for both books and ebooks in alleged violation of Section 1 of the Sherman Act.[9]

In June 2015, the U.S. Court of Appeals for the Second Circuit faced a question regarding the legality of these contracts in *United States v. Apple* ("*Apple II*").[10] To assess whether Apple's agreements with the publishing companies violated the Sherman Act, the court had to decide if the agreements were vertical or horizontal in order to apply the appropriate analysis.[11] In contrast to recent jurisprudence, the majority of the Second Circuit held that Apple facilitated a horizontal conspiracy to raise and set prices, which is per se illegal, through Apple's use of vertical contracts with the publishing companies that took the form of a hub-and-spoke arrangement."[12]

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[8] *Apple II*, 791 F.3d at 299, 302–05. The agency model gave publishers the ability to set retail prices. *Id.* at 303. A "most-favored-nations" ("MFN") clause is an agreement by one party, such as a supplier, to give the same conditions to the party with whom it is contracting as it does for its best customer. Jonathan B. Baker, *Vertical Restraints with Horizontal Consequences: Competitive Effects of "Most-Favored-Customer" Clauses*, 64 ANTITRUST L.J. 517, 519 (1996). These antidiscrimination clauses promote uniformity in pricing for different customers. *Id.* In an agency model, MFN clauses affect the retail price rather than the wholesale price. *See* Michael L. Weiner & Craig G. Falls, *Counseling on MFNS After E-Books*, 28 ANTITRUST, Summer 2014, at 68, 69 (explaining that MFNs in agency agreements, which are increasingly used for e-commerce, determines the retail price for the product sold on the agent's platform, whereas MFNs in wholesale agreements determine the wholesaler's price but not necessarily the retail price). Given Apple's agency model, the publishing companies would have to set the retail price at $9.99 for Apple's ebooks if they continued to use the wholesale agreement with Amazon. *Apple II*, 791 F.3d at 305.

[9] *Apple II*, 791 F.3d at 296, 310; *see also* Robert H. Lande, Symposium, *A Traditional and Textualist Analysis of the Goals of Antitrust: Efficiency, Preventing Theft from Consumers, and Consumer Choice*, 81 FORDHAM L. REV. 2359, 2350 (2013) (noting that one of the primary reasons for adopting the Sherman Act was to protect consumers from companies that raised prices to supracompetitive levels). Because of the price caps, the price of hardcovers directly affected the ebook prices. *See Apple II*, 791 F.3d at 296, 310 (noting that price caps in Apple's agreements affected both ebook and hardcover prices). Consequently, the publishers raised the prices of hardcovers in order to bring the corresponding ebooks into the higher price cap bracket. *Id.*; *see also supra* notes 81–83 and accompanying text (explaining that combination of MFN clause and price caps resulted in raised and fixed ebook prices, which eliminated all retail competition in violation of the Sherman Act).

[10] *Apple II*, 791 F.3d at 296.

[11] *See* Leegin Creative Leather Prods. v. PSKS, Inc., 551 U.S. 877, 887–88 (2007) (holding that sufficient economic differences require treating horizontal and vertical agreements differently); Bus. Elec. Corp. v. Sharp Elec. Corp., 485 U.S. 717, 730 (1988) (noting that generally, agreements between competitors result in horizontal restraints and agreements between parties at different market levels, such as retailer and distributor, result in vertical restraints).

[12] *See Apple II*, 791 F.3d at 297 (affirming district court's decision to hold Apple's conduct as per se unlawful because raising ebook prices constituted restraint on trade); *see, e.g.*, *Leegin*, 551 U.S. at 887–88 (defining vertical agreements as different from horizontal agreements when applying antitrust analysis); *Khan*, 522 U.S. at 10, 15 (applying rule of reason analysis for vertical price agreements and for agreements in businesses with which the courts are unfamiliar); Toledo Mack Sales & Serv. v. Mack Trucks, Inc., 530 F.3d 204, 225 (3d Cir. 2008) (holding that rule of reason analysis applies in

This Comment suggests that the Second Circuit misinterpreted the U.S. Supreme Court's 2007 holding in *Leegin Creative Leather Products v. PSKS, Inc.* in determining that Apple's agreements constituted a horizontal conspiracy to raise and fix prices and were therefore per se illegal.[13] Part I of this Comment provides an overview of Section 1 of the Sherman Act and the factual and procedural history of the *Apple II* decision.[14] Part II of this Comment examines the development of the standards by which horizontal and vertical agreements are analyzed for antitrust violations and how the majority and dissent in *Apple II* diverged over how to assess vertical agreements that have horizontal effects.[15] Finally, Part III of this Comment concludes that vertical price agreements, even if embedded in hub-and-spoke arrangements, are treated under the rule of reason to give parties, especially in new industries, the opportunity to present any procompetitive justifications.[16]

I. *UNITED STATES V. APPLE* AND APPLE'S RESTRAINTS OF TRADE

Section 1 of the Sherman Act protects against unreasonable restraints of trade.[17] What constitutes an unreasonable restraint of trade depends on what market forces are involved and what test applies to assess this unreasonableness.[18] Section A of this Part explains the history behind Section 1 of the Sherman Act.[19] Section B then describes the events culminating in Apple's alleged violation of the Sherman Act in the *Apple II* case.[20] Finally, Section C outlines the procedural history of *Apple II*.[21]

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hub-and-spoke context for vertical agreement even if vertical agreement furthers illegal horizontal conspiracy).

[13] *See infra* notes 93–113 and accompanying text.

[14] *See infra* notes 17–62 and accompanying text.

[15] *See infra* notes 63–92 and accompanying text.

[16] *See infra* notes 93–113 and accompanying text.

[17] *See* Sherman Act § 1, 15 U.S.C. § 1 (2012) (making illegal any contract that restrains trade or commerce among states); *Khan*, 522 U.S. at 10 (noting that Sherman Act's prohibition of restraints of trade limited to those that are unreasonable); *see also Toledo Mack*, 530 F.3d at 218 (noting that to bring a successful claim under Section 1 of the Sherman Act, the plaintiff must prove first, that the defendant was part of a contract, combination, or conspiracy, and second, that this conspiracy resulted in an unreasonable restraint on trade).

[18] *See Leegin*, 551 U.S. at 888 (noting that Court has applied different rules for agreements that are vertical as opposed to those that are horizontal); *Bus. Elec.*, 485 U.S. at 730 (showing that whether parties who form agreement are at different or same market levels determines whether agreement is vertical or horizontal).

[19] *See infra* notes 22–42 and accompanying text.

[20] *See infra* notes 43–52 and accompanying text.

[21] *See infra* notes 53–62 and accompanying text.

A. The Common Law Approach to Assessing Unreasonableness Under the Sherman Act

Though the Sherman Act prohibits any restraints of trade, common law has narrowed its application to just unreasonable restraints of trade.[22] Simply, any agreement that has a net anticompetitive effect is considered illegal.[23] What constitutes a restraint on trade, however, depends on the economic conditions at the time.[24]

To assess whether a restraint of trade is unreasonable, courts have established three tests: per se illegality, rule of reason analysis, and an abbreviated quick-look rule of reason approach.[25] Per se illegality deems conduct to be so harmful and anticompetitive that it does not warrant further analysis.[26] The plaintiff only needs to show that the defendant engaged in the challenged con-

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[22] Sherman Act § 1; *see Khan*, 522 U.S. at 10 (explaining that only unreasonable restraints, rather than all restraints, are illegal); *Tekton*, 676 F.2d at 1354 (limiting unlawful restraints of trade to those which "'unreasonably' restrict competition" (quoting *N. Pac. R.R.*, 356 U.S. at 5)); *see also* Laura Kaplan, Comment, *An Implicit Exemption, Implicitly Applied: Blurring the Line of Accommodation Between Labor Policy and Antitrust Law in* Harris v. Safeway, 53 B.C. L. REV. E-SUPP. 181, 184 n.28 (2012) (noting that Sherman Act has been narrowed to only banning "unreasonable restraints").

[23] *See* Gabriel A. Feldman, *The Misuse of the Less Restrictive Alternative Inquiry in Rule of Reason Analysis*, 58 AM. U. L. REV. 561, 562, 572, 577 (2009) (explaining that rule of reason applies a cost-benefit analysis to determine whether anticompetitive effects outweigh procompetitive justifications).

[24] *See Leegin*, 551 U.S. at 899 (observing that application of Sherman Act must change to reflect current economy); *Bus. Elec.*, 485 U.S. at 732 (holding that the Sherman Act, instead of being static, was enacted to evolve through the common law); *see also* Rebecca Haw, *Delay and Its Benefits for Judicial Rulemaking Under Scientific Uncertainty*, 55 B.C. L. REV. 331, 347 (2014) (noting that because the Sherman Act is analyzed under common law, what constitutes a restraint on trade must change with economic conditions).

[25] *See Nat'l Soc. of Prof'l Eng'rs*, 435 U.S. at 692 (identifying per se illegality and rule of reason as two means of assessing restraints on trade); *In re Ins. Brokerage Antitrust Litig.*, 618 F.3d at 315–17 (identifying quick look rule of reason as truncated version of standard rule of reason approach). In deciding whether per se illegality or the rule of reason applies, however, the courts still need to assess the current market. *See Nat'l Collegiate Athletic Ass'n*, 468 U.S. at 104 n.26 (noting that per se illegality, despite presumption of unlawfulness, still may involve market inquiry).

[26] *See Khan*, 522 U.S. at 10 (noting that per se unlawful restraints generally have damaging anticompetitive effects with little to no procompetitive justifications); FED. TRADE COMM'N & U.S. DEP'T OF JUSTICE, ANTITRUST GUIDELINES FOR COLLABORATIONS AMONG COMPETITORS 8 (2000), https://www.ftc.gov/sites/default/files/documents/public_events/joint-venture-hearings-antitrust-guidelines-collaboration-among-competitors/ftcdojguidelines-2.pdf [https://perma.cc/QQ9F-WKP2] [hereinafter FTC & DOJ GUIDELINES] (explaining that per se illegal agreements include those agreements among competitors designed to increase prices or limit output). This strict standard has been limited to instances of horizontal agreements that involve price fixing or market allocations. *See Leegin*, 551 U.S. at 886 (noting that per se illegality limited to those restraints that have demonstrated their anticompetitive effects with little to no procompetitive benefit, including agreements among direct competitors to fix prices or divide markets); *see also* NYNEX Corp. v. Discon, Inc., 525 U.S. 128, 138 (1998) (holding that per se rule inappropriate for boycotts unless evidence of horizontal agreement included).

duct.[27] Because per se illegality removes any need to study the restraint's potential procompetitive justifications, the application of this rule has been limited to conduct that always or almost always tends to restrict competition and decrease output.[28]

For the rule of reason analysis, the court balances the anticompetitive results of a restraint against its procompetitive justifications.[29] The plaintiff bears the burden of asserting any anticompetitive effects.[30] If the defendant is able to demonstrate any procompetitive effects, then the plaintiff must assert an alternative option that would have fewer anticompetitive results.[31] Thus, the rule of reason differentiates between those restraints that are anticompetitive and harmful and those that are procompetitive.[32]

The abbreviated quick-look rule of reason approach is used when the agreement is noticeably anticompetitive, but the defendant is given the opportunity to put forth any plausible justifications that promote the value of compe-

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[27] *See* FTC & DOJ GUIDELINES, *supra* note 26, at 3 (noting that per se illegality forecloses Court from assessing any anticompetitive or procompetitive effects); *see also* Fed. Trade Comm'n v. Superior Court Trial Lawyers Ass'n, 493 U.S. 411, 430 (1990) (holding that administrative efficiency derived from per se rule saves courts from having to delve into industry and market effects to prove restraint unreasonable (citing *N. Pac. R.R.*, 356 U.S. at 5)).

[28] *Bus. Elec.*, 485 U.S. at 723 (citing Nw. Wholesale Stationer's, Inc. v. Pac. Stationery & Printing Co., 472 U.S. 284, 289–90 (1985)); *see Leegin*, 551 U.S. at 894 (noting that per se illegality inappropriate when there are sufficient procompetitive justifications); FTC & DOJ GUIDELINES, *supra* note 26, at 3 (noting that per se illegality precludes Court's consideration of agreement's anticompetitive or procompetitive impact on market); *see also* Major League Baseball Props., Inc. v. Salvino, Inc., 542 F.3d 290, 316 (2d Cir. 2008) (holding that per se rule inappropriate when "economic and competitive effects of the challenged practice are unclear"). For example, the per se illegality test is applied when direct competitors boycott each other or agree to fix prices. Texaco, Inc. v. Dagher, 547 U.S. 1, 5 (2006); *NYNEX*, 525 U.S. at 135; *see also* Christopher R. Leslie, Comment, *Achieving Efficiency Through Collusion: A Market Failure Defense to Horizontal Price-Fixing*, 81 CALIF. L. REV. 243, 246 (1993) (identifying horizontal price fixing, group boycotts, tying arrangements, and market-dividing agreements as per se illegal restraints of trade).

[29] Geneva Pharm. Tech. Corp. v. Barr Lab., Inc., 386 F.3d 485, 507 (2d Cir. 2004); *Federal Statutes and Regulations: The Supreme Court, 2009 Term: Leading Cases, Section III*, 124 HARV. L. REV. 340, 405–06 (2010) [hereinafter *Leading Cases*] (noting that, unlike per se rule of illegality, the agreements under the rule of reason are presumptively legal until proven otherwise). Overall, the rule of reason considers the nature of the industry, the type of restraint on the market, and the reasons for the restraint's existence. *Topco Assocs.*, 405 U.S. at 607; Bd. of Trade of Chi. v. United States, 246 U.S. 231, 238 (1918). *But see* Edward Cavanagh, *The Rule of Reason Re-Examined*, 67 BUS. LAW. 435, 437 (2012) (explaining that the rule of reason analysis is a "mess" because of its "(1) high costs, (2) lack of predictability, and (3) significant risk of error").

[30] *Geneva Pharm. Tech. Corp.*, 386 F.3d at 506.

[31] *Id.* at 507.

[32] *See Nat'l Soc. of Prof'l Eng'rs*, 435 U.S. at 691–92 (explaining that rule of reason assesses restraint's impact on competition); *see also* Michael A. McCann, *Antitrust, Governance, and Postseason College Football*, 52 B.C. L. REV. 517, 533 (2011) (observing that in reality rule of reason favors defendants and allows agreements in which procompetitive justifications offset anticompetitive effects).

tition.[33] This hybrid analysis is generally reserved for restraints that are inherently suspect but may have sufficient reasons to not warrant per se treatment.[34]

Generally, there are two types of parties who collude to form these restraints of trade: parties on the same market level who form horizontal agreements and parties on different market levels who form vertical agreements.[35] Horizontal agreements are considered the typical form of per se restraints on trade.[36] By contrast, vertical agreements are not necessarily unlawful.[37] Be-

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[33] *Leading Cases*, *supra* note 29, at 406; *see Texaco*, 547 U.S. at 7 n.3 (noting that quick look approach reserved for agreements that are obviously anticompetitive and obviate further inquiry); *Cal. Dental*, 526 U.S. at 770 (explaining that quick look analysis applied when anticompetitive effects are readily apparent).

[34] *See Major League Baseball Props.*, 542 F.3d at 317–18 (citing *Cal. Dental*, 526 U.S. at 759, 771) (explaining that, because quick look analysis limited to agreements that are obviously anticompetitive, rule of reason appropriate standard if agreement has net procompetitive effect or no effect on competition). *But see Leading Cases*, *supra* note 29, at 406 (noting that in practice, inquiry into procompetitive justifications has set bar too high for defendants). For example, in 2010, in *American Needle, Inc. v. National Football League*, the U.S. Supreme Court suggested that the quick look rule of reason could be applied to the NFL's licensing agreements. 560 U.S. 183, 203 (2010); *see Leading Cases*, *supra* note 29, at 401 (showing that Court's application of quick look analysis, specifically holding that the NFL's contracts could survive such analysis, was a rare moment for agreements subject to this type of evaluation); *see also* PHILIP AREEDA, FED. JUD. CTR., THE "RULE OF REASON" IN ANTITRUST ANALYSIS: GENERAL ISSUES 37–38 (1981), http://www.fjc.gov/public/pdf.nsf/lookup/antitrust.pdf/$file/antitrust.pdf [https://perma.cc/4TUT-5TH5] (noting that in situations in which two major corporations, such as Ford and General Motors, form a selling arrangement, their conduct may not be necessarily unlawful per se, but the anticompetitive effects are so apparent that a court does not need to consider them).

[35] *Bus. Elec.*, 485 U.S. at 730; *see NYNEX*, 525 U.S. at 136 (holding that vertical agreement between supplier and customer and horizontal agreement between competitors); *see also* Roger D. Blair & Jeffrey L. Harrison, *Cooperative Buying, Monopsony Power, and Antitrust Policy*, 86 NW. U. L. REV. 331, 366 (1992) (discussing how horizontal agreement exists when competing buyers collude); Jordan A. Dresnick & Thomas A. Tucker Ronzetti, *Vertical Price Agreements in the Wake of* Leegin v. PSKS*: Where Do We Stand Now?*, 64 U. MIAMI L. REV. 229, 230–31 (2009) (identifying vertical agreements as between manufacturer, an upstream party, and distributor, a downstream party).

[36] Catalano v. Target Sales, Inc., 446 U.S. 643, 647 (1980); *see also Superior Court Trial Lawyers Ass'n*, 493 U.S. at 434 (holding that horizontal price-fixing agreements pose threat to free market); United States v. Socony-Vacuum Oil Co., 310 U.S. 150, 225–26 n.59 (1940) (noting that price fixing agreements unlawful because of threat to "central nervous system of the economy"); Louis Kaplow, *On The Meaning of Horizontal Agreements in Competition Law*, 99 CALIF. L. REV. 683, 694–95 (2011) (explaining that identifying horizontal agreements between direct competitors is easy when there is a clear agreement or promise between the parties but becomes more difficult when there is no clear meeting of the minds); M. Laurence Popofsky, *Does* Leegin *Liberate the Law Governing Horizontal Conspiracies from Its Vertical Contamination?*, 78 ANTITRUST L.J. 23, 28 (2012) (addressing dual concerns arising from horizontal agreements in that they create an otherwise impossible restraint in the market and have the potential to create otherwise nonexistent market power). Though the Court has narrowed its application of the per se rule, horizontal price-fixing continues to be considered per se illegal. *See* Leslie, *supra* note 28, at 249 (explaining that Court's persistently strict regard for horizontal price-fixing based on belief that agreement is "necessarily anticompetitive and inefficient").

[37] *See* Cont'l T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36, 54 (1977) (discussing how vertical agreements' benefit in furthering interbrand competition outweighs potential harm of limiting intrabrand competition).

cause of the potential procompetitive effects of vertical agreements, courts have slowly moved towards the more lenient rule of reason for analyzing vertical restraints.[38]

Not all agreements, however, are clearly delineated as horizontal or vertical; agreements may consist of a combination of horizontal and vertical agreements.[39] One such example of these hybrid agreements is hub-and-spoke conspiracies, in which one agent, the hub, creates multiple parallel agreements with individual parties, the spokes, who are at a different level of the market.[40] Any agreement that the hub makes with the spokes would be considered a vertical agreement and therefore would likely be treated under the rule of reason analysis.[41] If the spokes have made any agreements among themselves, however, they create a "rim" to the agreement, which would be considered a horizontal conspiracy.[42]

B. Apple's Entry into the eBook Industry

Apple included the iBookstore as one of its features on its iPad in 2010.[43] The iBookstore is an application that functions as a virtual marketplace, enabling users to buy and download ebooks to read on the iPad.[44] In order to compete with Amazon's Kindle, Apple negotiated with the "Big Six" publishing companies to create new retail agreements for its ebooks.[45] Knowing that the

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[38] *See Leegin*, 551 U.S. at 898–99 (holding that rule of reason serves to remove anticompetitive agreements from the market); *Cont'l T.V.*, 433 U.S. at 54 (noting that Court has increasingly applied rule of reason for vertical restraints because per se illegality too rigid); *see also In re Ins. Brokerage Antitrust Litig.*, 618 F.3d at 318 (holding that rule of reason analysis applied to almost all vertical agreements). Such procompetitive effects derived from cooperation between manufacturers and retailers can include increased interbrand competition and efficiency. Carlo Luis Rodes, Note, *Giving Teeth to Sherman Act Enforcement in the Intrabrand Context: Weaning Courts Off Their Interbrand Addiction Post*-Sylvania, 84 NOTRE DAME L. REV. 957, 959 (2009).

[39] *See* Howard Hess Dental Lab., Inc. v. Dentsply Intern, Inc., 602 F.3d 237, 254–55 (3d Cir. 2010) (showing that hub-and-spoke conspiracies consist of both vertical and horizontal conspiracies).

[40] *Id.* at 255; Total Benefits Planning Agency, Inc. v. Anthem Blue Cross & Blue Shield, 552 F.3d 430, 435 n.3 (6th Cir. 2008).

[41] *See Total Benefits*, 552 F.3d at 435 n.3 (noting that though there are multiple parallel agreements between the hub and spokes, there still must be a horizontal agreement among the spokes in order for per se illegality to apply).

[42] *Howard Hess*, 602 F.3d at 255; *Total Benefits*, 552 F.3d at 435 n.3. The U.S. Court of Appeals for the Sixth Circuit has acknowledged that there are "no special exceptions" for hub-and-spoke conspiracies in applying the per se standard. *Total Benefits*, 552 F.3d at 435. Instead, the plaintiffs must still prove that a horizontal agreement exists among the spokes; otherwise, a rimless hub-and-spoke agreement generally falls under rule of reason analysis. *Id.* at 436.

[43] *Apple II*, 791 F.3d at 301.

[44] *Id.* at 296.

[45] *Id.* at 301–02, 305. As one of the only ebook retailers, Amazon enjoyed 90% of the ebook industry market in 2010. *Id.* at 301; *see also* Maher, *supra* note 7 (discussing how Amazon's domination of ebook market enabled company to dictate prices to publishers). Apple worked with what were collectively referred to as the "Big Six": Hachette, Harper Collins, Macmillan, Penguin, Random

Big Six hoped to eliminate Amazon's $9.99 price standard, Apple offered to implement price caps for all ebooks sold through agency model contracts.[46] The price caps that Apple's contracts established created a ceiling for publishers' prices.[47]

Additionally, Apple included a MFN clause in its contracts with each publishing company.[48] This clause forced the publishing companies to change the contracts for all of their retailers.[49] The resultant contracts enabled the publishing companies to obtain control over ebook pricing.[50] The immediate effect of these changes was an increase in both ebook and physical book prices and a reduction in the publishing companies' sales.[51] Although this change did elim-

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House, and Simon & Schuster. *Apple II*, 791 F.3d at 298. Except for Random House, five of the Big Six entered into contracts with Apple and became the Publishing Defendants in *Apple II*. *Id.* at 296–98. Together, the Big Six published 90% of the *New York Times* bestsellers in the United States in 2010. *Id.* Despite competing over authors and agents, these publishers were in relative harmony regarding pricing strategies. *See id.* at 300 (noting that publishers joined together to try and eliminate Amazon's $9.99 price standard).

[46] *Apple II*, 791 F.3d at 301–04. Amazon used a traditional wholesale model, in which the publishers suggested a list price for ebooks and received a wholesale price for each sold, but the retailers set the retail price for each ebook. *Id.* at 299. Because ebooks were cheaper to manufacture, store, and deliver, both the wholesale and retail price for ebooks were generally less than their hardcover or paperback counterparts. *Id.* In order to entice consumers to buy the Kindle, however, Amazon implemented a "loss leader" strategy, meaning it set the retail price of certain ebooks below the wholesale price, thereby incurring short-term costs in return for potential long-term gains. *Id.*; *see also*, Michael L. Weiner, *Loss Leaders as Misleaders? State Bans on Below Cost Pricing*, 8 ANTITRUST 10, 12 (1994) (explaining that state statutes prohibiting loss leader, or "sales below cost" strategy, seem to contradict the Sherman Act's emphasis on free competition, but protect smaller merchants from being priced out entirely). Despite the defendants' complaints of Amazon's "predatory" pricing, the U.S. District Court for the Southern District of New York dismissed these complaints because they failed to prove that Amazon's prices "were below its marginal costs," and, even if they were predatory, the solution was not to unlawfully fix prices. United States v. Apple, Inc. (*Apple I*), 889 F. Supp. 2d 623, 642 (S.D.N.Y. 2012), *aff'd*, *Apple II*, 791 F.3d 290, *cert. denied*, 2016 WL 854227. In 1997, in *State Oil Co. v. Khan*, the U.S. Supreme Court held that the legality of such vertical maximum price fixing should be assessed under the rule of reason. 522 U.S. at 15, 17.

[47] *Apple II*, 791 F.3d at 303–04.

[48] *Id.* at 304–05.

[49] *Id.* Historically, MFN clauses have not been challenged as antitrust violations in court. *See* Weiner, *supra* note 8, at 68 (discussing how, until *Apple I*, MFNs were not considered unlawful because they generally do not result in anticompetitive restraints on the market). Unlike wholesale models, in which the retailer sets the price, the agency model allowed the publishers to set the prices for ebooks; the retailer then pays a fixed percentage for each sale. *Apple II*, 791 F.3d at 303. If the publishers maintained the wholesale model with Amazon while agreeing to the agency model with Apple, Amazon could continue to use its $9.99 "loss leader" strategy unabated and the publishers, due to the MFN clause's best-terms agreement, would be forced to match the $9.99 pricing for Apple. *Id.* at 305. To retain control over pricing and raise prices to maintain a profit, the publishers needed to switch all retailers to an agency model. *Id.* Even after Apple signed contracts with each of the Publishing Defendants, it continued to monitor their negotiations with Amazon to ensure that Amazon was switched from the wholesale model to the agency model. *Id.* at 309.

[50] *Apple II*, 791 F.3d at 303.

[51] *Id.* at 310–11. At trial, one expert compared the post-contract sales to pre-contract sales and calculated that the Publishing Defendants experienced a 12.9% loss in sales; another expert compared

inate Amazon's $9.99 price standard, Apple's contracts allegedly violated Section 1 of the Sherman Act as they raised and set prices for ebooks.[52]

C. Apple's Failed Battle to Justify Its Contracts

In April of 2012, the Department of Justice and thirty-three states and territories filed a civil complaint against Apple and the publishing companies who signed agreements with Apple ("Publishing Defendants"), alleging a violation of the Sherman Act.[53] The Department of Justice argued that Apple and the Publishing Defendants colluded in fixing retail prices for bestsellers and newly released ebooks, which would have eliminated price competition among retailers.[54] After a three-week bench trial, the U.S. District Court for the Southern District of New York found Apple guilty of violating Section 1 of the Sherman Act.[55] The court found that, through its contracts, Apple assembled a group of competitors who increased and set prices, thereby eliminating any retail price competition.[56] The court held that Apple's involvement as a hub in a hub-and-spoke conspiracy to raise and set prices was per se unlawful.[57]

Apple appealed the verdict.[58] In a split decision, a panel of the Second Circuit affirmed the conviction in 2015, finding Apple's contracts to be per se illegal and in violation of Section 1 of the Sherman Act.[59] Recognizing the

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the Publishing Defendants' sales to Random House, which had not solidified an agreement with Apple, to find that the Publishing Defendants' experienced a 14.5% loss in sales. *Id.*

[52] *See* Sherman Act § 1, 15 U.S.C. § 1 (2012) (outlawing all contracts or conspiracies that restrain trade); *Apple II*, 791 F.3d at 296 (holding that Apple's agreement with the Publishing Defendants to raise ebook prices constituted a violation of the Sherman Act).

[53] Complaint at 1, *Apple I*, 952 F. Supp. 2d 638 (No. 12 CV 2826), 2012 WL 1193205; *see* Sherman Act § 1 (prohibiting any contract or conspiracy that restrains trade); *Apple I*, 952 F. Supp. 2d at 645, 687 (arguing that Apple violated the Sherman Act by forming agreements with the Publishing Defendants to raise and fix ebook prices).

[54] *Apple I*, 952 F. Supp. 2d at 645. Although the Publishing Defendants settled with the Department of Justice, Apple proceeded to trial. *Apple II*, 791 F.3d at 296–97. The Publishing Defendants agreed to a two-year provision to refrain from entering into any agreements that would restrict or impede ebook retailers' ability to set, alter, or reduce ebook prices. *Id.* at 296–97, 312.

[55] *Apple I*, 952 F. Supp. 2d at 694; *see* Sherman Act § 1 (prohibiting any contract or conspiracy that restrains trade).

[56] *Apple I*, 952 F. Supp. 2d at 647–48, 686, 709.

[57] *Id.* at 706–07. The district court also found that regardless of the contracts' per se illegality, Apple's contracts still would have been found illegal under the rule of reason analysis. *Id.* at 694.

[58] *Apple II*, 791 F.3d at 321.

[59] *Id.* at 297, 335, 339. The district court's injunctive order prohibited Apple from using MFN clauses and required Apple to treat the iBookstore's contractual provisions in the same way as its other apps. *Id.* at 313. The majority distinguished *Apple II* from the Supreme Court's *Leegin* precedent in that Apple, as a hub, facilitated the horizontal conspiracy among the publishers, the spokes. *Id.* at 324–25. The majority instead relied on the 1959 U.S. Supreme Court decision in *Klor's, Inc. v. Broadway-Hale Stores, Inc*, as well as the 1966 U.S. Supreme Court decision in *United States v. General Motors Corp.* to support its holding that it is the restraint imposed on trade that matters for purposes of per se illegality and not the arrangement of agreements. *Id.* at 322–23 (citing United States v. Gen. Motors Corp., 384 U.S. 127 (1966); *Klor's*, 359 U.S. 207).

novelty of the ebook industry, Judge Debra Ann Livingston, writing alone, applied the quick-look rule of reason analysis and affirmed the conviction.[60] Judge Raymond J. Lohier concurred solely on the application of per se illegality and resultant conviction.[61] The lone dissenter, Judge Dennis Jacobs, would have reversed Apple's conviction, finding the use of per se illegality inappropriate for a vertical agreement.[62]

II. Architecture or Effects? Majority of Second Circuit Focused on Effects that Vertical Agreement Had on Horizontal Retailers Whereas Dissent Focused on Structure of Agreement

The U.S. Court of Appeals for the Second Circuit majority panel's 2015 decision in *United States v. Apple* ("*Apple II*") demonstrates the ongoing confusion in applying per se illegality versus rule of reason analysis for hub-and-spoke conspiracy agreements.[63] Generally, vertical agreements are found among forces at different market levels, such as between distributor and manufacturer.[64] In contrast, horizontal agreements are found among forces at the same market level, or among direct competitors.[65] Significantly, in 2007, in *Leegin Creative Leather Products v. PSKS, Inc.*, the U.S. Supreme Court held that even if the vertical agreement verified the horizontal conspiracy's presence, the agreement itself was still vertical.[66]

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[60] *See Apple II*, 791 F.3d at 329–35 (applying rule of reason analysis to address possible procompetitve justifications from Apple's innovation). Judge Livingston held that per se illegality was still the appropriate test to apply for Apple's agreements, but she acknowledged Apple's argument regarding the innovation of the business. *Id.* at 329. Under both per se illegality and the quick look rule of reason, however, Judge Livingston found that Apple's agreements were unlawful. *Id.* at 329–30.

[61] *See id.* at 339–40 (Lohier, J., concurring) (noting that because Apple's appeal depended only on the application of the per se rule, the court should not have considered the rule of reason analysis and instead should have affirmed the conviction based only on the contracts' per se illegality).

[62] *See id.* at 340–41, 347–48 (Jacobs, J., dissenting) (emphasizing both the architecture of the agreements as well as the procompetitive effects to highlight majority's error in applying per se illegality). The dissent relied on the Supreme Court's precedent in *Leegin* and the Third Circuit's persuasive decision in *Toledo Mack* to find that the majority should have applied the rule of reason analysis when a vertical agreement facilitates a horizontal conspiracy, such as in the case of a rimmed hub-and-spoke conspiracy. *Id.* at 346–47.

[63] *See* United States v. Apple, Inc. (*Apple II*), 791 F.3d 290, 314, 322 (2d Cir. 2015) (looking at restraint's effect on market rather that at composition of agreement), *cert. denied*, No. 15-565, 2016 WL 854227 (Mar. 7, 2016) (mem.); *see also* Nat'l Collegiate Athletic Ass'n v. Bd. of Regents of Univ. of Okla., 468 U.S. 85, 104 n.26 (1984) (holding that because of dependence on market conditions, no bright line exists between per se illegality and rule of reason analysis).

[64] *See* Bus. Elec. Corp. v. Sharp Elec. Corp., 485 U.S. 717, 730 (1988) (differentiating between horizontal and vertical agreements).

[65] *See id.* at 730–31 n.4 ("[A] restraint is horizontal not because it has horizontal effects, but because it is the product of a horizontal agreement.").

[66] *See* Leegin Creative Leather Prods. v. PSKS, Inc., 551 U.S. 877, 893 (2007) (holding that if a cartel, which is a group of competing manufacturers or retailers on the same market level, conspires to decrease output or reduce competition, the agreement is per se illegal).

The distinction between horizontal and vertical agreements is essential for antitrust cases in that it determines what analysis applies to assess the agreements' legality.[67] Traditionally, vertical agreements that set prices were considered illegal per se.[68] Per se illegality is significantly more efficient than the rule of reason in that it alleviates the parties' burden of demonstrating economic conditions and any procompetitive or anticompetitive effects.[69]

Common law, however, has gradually shifted away from applying per se illegality for vertical agreements.[70] In 1977, in *Continental T.V., Inc. v. GTE Sylvania,* the U.S. Supreme Court narrowed its application of per se illegality, holding that vertical nonprice agreements lacked the anticompetitive effects to justify per se illegality.[71] Because vertical nonprice agreements are widely used and lack pernicious anticompetitive effects, the Court held that these restraints could be appropriately policed through the rule of reason.[72] In 1997, in *State Oil Co. v. Khan,* the U.S. Supreme Court further limited the application of per se illegality by rejecting that rule for vertical agreements that set maximum prices.[73] Finally, in 2007, in *Leegin,* the U.S. Supreme Court, in ruling that vertical agreements to set minimum prices should also be analyzed through the

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[67] *See id.* at 888 (holding that rules governing horizontal restraints diverge from rules governing vertical restraints); *Bus. Elec.*, 485 U.S. at 730 (holding that horizontal restraints comprised of agreements among competitors and vertical restraints comprised of agreements among forces at different levels of distribution); *In re* Ins. Brokerage Antitrust Litig., 618 F.3d 300, 318 (3d Cir. 2010) (noting that essentially all vertical agreements analyzed under rule of reason).

[68] *See* Dr. Miles Med. Co. v. John D. Park & Sons Co., 220 U.S. 373, 405 (1911) (holding that manufacturers prohibited from fixing prices), *overruled by Leegin*, 551 U.S. 877; Thomas B. Leary & Erica S. Mintzer, *The Future of Resale Price Maintenance, Now that* Doctor Miles *Is Dead*, 4 N.Y.U. J. L. & BUS. 303, 303, 307 (2007) (explaining how agreements between buyers and sellers to fix prices were considered per se illegal from 1911 to 2007).

[69] *See* Fed. Trade Comm'n v. Superior Court Trial Lawyers Ass'n, 493 U.S. 411, 430 (1990) (citing N. Pac. R.R. Co. v. United States, 356 U.S. 1, 5 (1958) (noting that per se illegality removes arduous task of market investigation simply to determine whether restraint unreasonable).

[70] *See* Total Benefits Planning Agency, Inc., v. Anthem Blue Cross & Blue Shield, 552 F.3d 430, 434–35 (6th Cir. 2008) (showing that, after *Leegin*, only horizontal agreements forming group boycotts evaluated as per se unlawful); *see also* NYNEX Corp. v. Discon, Inc., 525 U.S. 128, 135 (1998) (limiting per se rule for boycotts to horizontal agreements among direct competitors). Although per se illegality has administrative benefits, this rule proscribes any possibility of procompetitive justifications. *See Superior Court Trial Lawyers Ass'n*, 493 U.S. at 430 (1990) (citing *N. Pac. R.R. Co.*, 356 U.S. at 5) (explaining how per se illegality obviates need to investigate market as restraint is simply considered per se unreasonable).

[71] 433 U.S. 36, 57–59 (1977).

[72] *Id.* at 58–59.

[73] 522 U.S. 3, 15–17 (1997). The Court in *Khan* believed there was insufficient economic justification to warrant applying per se illegality to vertical price fixing. *Id.* at 18. The Court instead considered the rule of reason to be the appropriate standard with which to police vertical maximum price agreements. *Id.* at 17.

rule of reason, overturned the 1911 decision from *Dr. Miles Medical Co. v. John D. Park & Sons Co*.[74]

Notably, the majority in *Apple II* acknowledged this shift in jurisprudence away from applying per se illegality for vertical restraints.[75] The majority, however, distinguished *Leegin* and its progeny from other hub-and-spoke cases in which the vertical agreements that furthered a horizontal price-fixing conspiracy were per se unlawful.[76] The majority found support for its argument in the U.S. Supreme Court's 1959 decision in *Klor's, Inc. v. Broadway-Hale Stores, Inc.*, in which the Court held that an agreement between a retailer and its distributors to boycott a competing retailer, despite being a vertical agreement, represented a per se restraint.[77] The majority in *Apple II* concluded that vertical organizers who enter into vertical agreements in addition to participating in horizontal price-fixing conspiracies are liable for the horizontal conspiracy.[78]

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[74] *Leegin*, 551 U.S. at 894; *Dr. Miles Med. Co.*, 220 U.S. at 405. Technically, the *Leegin* decision only applied to vertical minimum price-fixing agreements, but the Court acknowledged that resale price maintenance, arising from both vertical and horizontal agreements, can have procompetitive benefits. *See Leegin*, 551 U.S. at 898–99 (noting that rule of reason used to weed out anticompetitive restraints while furthering procompetitive effects of vertical price agreements); *Total Benefits*, 552 F.3d at 435 (explaining how *Leegin* decision overturned per se treatment of vertical price restraints in favor of rule of reason analysis); *see also* Leary, *supra* note 68, at 325 (discussing how in the Court's decision to apply rule of reason analysis to vertical price agreements in *Leegin*, the Court recognized that such agreements can have procompetitive impact on market).

[75] *Apple II*, 791 F.3d at 321.

[76] *Id.* at 324–25; *see* United States v. Gen. Motors Corp., 384 U.S. 127, 144–45 (1966) (holding that multilateral action between General Motors and its dealers to boycott discounters is per se restraint of trade); *see also* Klor's, Inc. v. Broadway-Hale Stores, Inc., 359 U.S. 207, 212–13 (1959) (holding that agreement among manufacturers, distributors, and retailers to boycott a retail store was per se unlawful).

[77] *Klor's*, 359 U.S. at 212–13; *Apple II*, 791 F.3d at 322. The Court's decision in *Klor's* does not differentiate between horizontal and vertical agreements but instead points to the "wide combination" of manufacturers, distributors, and retailers in asserting the per se rule. *Klor's*, 359 U.S. at 212–13; *see also Gen. Motors*, 384 U.S. at 145 (holding that joint collaboration among manufacturers and dealers was per se violation of Sherman Act). Judge Lohier's concurrence in *Apple II* agreed with this distinction from *Leegin*, affirming on the basis that Apple's vertical agreement was just part of the horizontal agreement among the publishers to fix ebook prices. *Apple II*, 791 F.3d at 339–40 (Lohier, J., concurring). More recently, in 2000, in *Toys "R" Us, Inc. v. Federal Trade Commission*, the U.S. Court of Appeals for the Seventh Circuit held that a retailer who formed individual vertical agreements with multiple manufacturers created a horizontal agreement to boycott other retailers that was per se unlawful. 221 F.3d 928, 935–36 (7th Cir. 2000). Through these vertical agreements, the manufacturers cut down on production in exchange for the retailer's protection against cheaters. *Id.* The majority in *Apple II* referenced the Seventh Circuit decision when considering that Apple's contracts protected the publishing companies from Amazon's $9.99 price standard. *Apple II*, 791 F.3d at 318 (majority opinion). The dissent in *Apple II* noted that this jurisprudential support, however, predates the U.S. Supreme Court's decision in *Leegin*. *Id.* at 347 (Jacobs, J., dissenting).

[78] *Apple II*, 791 F.3d at 323–25 (majority opinion). *But see Bus. Elec.*, 485 U.S. at 730 n.4 (holding that a restraint is horizontal "not because it has horizontal effects, but because it is the product of a horizontal agreement").

To reach this conclusion, the majority in *Apple II* disregarded the traditional distinction between horizontal and vertical agreements and instead focused on the type of restraint that Apple's contracts imposed.[79] This shift resulted from the hub-and-spoke nature of the conspiracy.[80] Apple, acting as the hub, entered into individual contracts with each Publishing Defendant, or the spokes.[81] The Publishing Defendants separately conspired to raise and fix prices in order to eliminate Amazon's $9.99 price standard, thereby completing the rim of the wheel.[82] It was this agreement to raise prices that the majority found violated the Sherman Act, but the MFN clause in Apple's contracts provided the economic impetus to ensure the publishers' collective action.[83] Thus, Apple's vertical agreement facilitated the horizontal conspiracy to raise and set ebook prices.[84] Given that horizontal agreements to fix prices are considered the paradigm of anticompetitive conduct, the majority logically considered these agreements per se unlawful.[85]

Unlike the majority's assertion that a vertical agreement that facilitates a horizontal conspiracy is per se illegal, the dissenting judge agreed with the Third Circuit's 2008 decision in *Toledo Mack* in applying *Leegin* to all vertical

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[79] *Apple II*, 791 F.3d at 322, 325.

[80] *Id.* at 324–25; *see also Toys "R" Us*, 221 F.3d at 935–36 (holding that distributor facilitated horizontal agreement among manufacturers to reduce output).

[81] *See Apple II*, 791 F.3d at 303–05, 324–25 (noting that Apple's involvement in the horizontal agreement among the Publishing Defendants to raise prices averted any potential confusion with the hub-and-spoke context); *see also Total Benefits*, 552 F.3d at 436 (identifying combinations among market forces as hub-and-spoke conspiracies).

[82] *Apple II*, 791 F.3d at 302; *see also Total Benefits*, 552 F.3d at 436 (holding that the spokes' connection, or the rim of the wheel, determines whether the hub and spoke committed a per se violation).

[83] *Apple II*, 791 F.3d at 320, 325, 327. Generally, a MFN clause requires the party setting the price to give the other party the best terms that any other competitor receives. *Id.* at 304. This clause forced the Publishing Defendants to switch all of its contracts with ebook retailers to an agency model. *Id.* at 305. Otherwise, Amazon could have continued its $9.99 price standard and the Publishing Defendants, despite controlling prices through the agency model, would have been forced to match this price for Apple. *Id.* at 304–05. Considering that the Publishing Defendants controlled a majority of the book industry, they had sufficient market power to effectively fix prices. *See id.* at 298 (pointing out that in 2010 Publishing Defendants published 90% of books listed on the *New York Times* Bestsellers list); *see also* Toledo Mack Sales & Serv. v. Mack Trucks, Inc., 530 F.3d 204, 217 n.8 (3d Cir. 2008) (holding that collusion possible when manufacturers agree with retailers to artificially raise prices). The majority did not find that Apple's contracts themselves were the subject of the Sherman Act violation, but instead pointed to Apple's organization of the horizontal conspiracy as the per se unlawful conduct. *Apple II*, 791 F.3d at 323, 327.

[84] *See Apple II*, 791 F.3d at 327, 339 (noting that Apple capitalized on Publishing Defendants' concern with Amazon's prices in order to raise prices in the ebook market).

[85] Texaco, Inc. v. Dagher, 547 U.S. 1, 5 (2006); *Nat'l Collegiate Athletic Ass'n*, 468 U.S. at 107–08; *see also* United States v. Socony-Vacuum Oil Co., 310 U.S. 150, 226 n.59 (1940) (holding that price-fixing agreements banned without inquiry into any procompetitive justifications, because they pose a "threat to the central nervous system of the economy"); *Superior Court Trial Lawyers Ass'n*, 493 U.S. at 434 (holding that horizontal agreements for boycotts or price fixing pose threat to free market).

agreements.[86] Rather than merging vertical agreements into the horizontal conspiracy for hub-and-spoke conspiracies, the dissent separated the horizontal and vertical agreements in accordance with the U.S. Supreme Court's decision in *Leegin*.[87] As a strictly vertical agreement, therefore, the dissent argued that Apple's contracts with the Publishing Defendants should have been analyzed through the rule of reason.[88]

Both Judge Livingston and Judge Jacobs in *Apple II* acknowledged that the ebook industry is relatively new and therefore may deserve rule of reason treatment.[89] Given the developing ebook technology and the switch to agency models over the traditional wholesale models, the industry is arguably novel enough to warrant rule of reason analysis.[90] Significantly, the dissent in *Leegin* conceded that the per se rule should be modified for those agreements that constitute "new entry" into the market.[91] In joining the ebook industry, Apple's argument that the provisions of its contracts were necessary as a new entrant

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[86] *Apple II*, 791 F.3d at 324–25; *id.* at 346–47 (Jacobs, J., dissenting) (citing *Leegin*, 551 U.S. at 893); *see Toledo Mack*, 530 F.3d at 225 (observing that rule of reason analysis applicable despite manufacturers purposefully forming vertical agreements to help retailers' illegal horizontal agreements). Per the ruling in *Toledo Mack*, only the horizontal agreement that constitutes the rim of the conspiracy to fix prices among competitors is considered per se illegal. *Toledo Mack*, 530 F.3d at 221.

[87] *See Leegin*, 551 U.S. at 888 ("[T]he Court [has] rejected the approach of reliance on rules governing horizontal restraints when defining rules applicable to vertical ones."); *Apple II*, 791 F.3d at 346–48 (Jacobs, J., dissenting) (arguing that every restraint is classified as either vertical or horizontal and is assessed accordingly). First, in pointing to *Leegin*'s overruling the Supreme Court's 1911 decision in *Dr. Miles Med. Co. v. John D. Park & Sons Co.*, the dissent emphasized that a manufacturer's agreement that facilitates the retailers' ability to set minimum prices was no longer considered per se unlawful. *Apple II*, 791 F.3d at 346 (Jacobs, J., dissenting) (citing *Leegin*, 551 U.S. 877; *Dr. Miles Med. Co.*, 220 U.S. 373). Then, the dissent reiterated *Leegin*'s holding for analyzing hub-and-spoke agreements under the rule of reason: "To the extent a vertical agreement setting minimum resale prices is entered upon to *facilitate* either type of cartel . . . it, too, would need to be held unlawful under the rule of reason." *Id.* (quoting *Leegin*, 551 U.S. at 893).

[88] *Apple II*, 791 F.3d at 347–48 (Jacobs, J., dissenting). The dissent went on to evaluate Apple's contracts through the rule of reason, addressing both the procompetitive and anticompetitive effects of the contracts. *Id.* at 349–51.

[89] *Id.* at 329 (majority opinion); *id.* at 348 (Jacobs, J., dissenting); *see also* United States v. Topco Assocs., Inc., 405 U.S. 596, 607–08 (1972) (holding that per se rule should only be used once courts have had "considerable experience" with business relationship at issue); Fed. Trade Comm'n v. Ind. Fed. of Dentists, 476 U.S. 447, 458–59 (1986) (holding that courts are generally slow in applying per se rule when economic impact of certain practices not immediately obvious).

[90] *See Apple II*, 791 F.3d at 299, 303 (observing both that the ebook industry, which only had one e-reader prior to the Kindle in 2007, doubled in revenue between 2007 and 2008 to $140 million, and that the agency model was not previously used in the publishing industry); *id.* at 348 (Jacobs, J., dissenting) (noting that business relationships unfamiliar to the court point in favor of using rule of reason analysis, not per se rule).

[91] *Leegin*, 551 U.S. at 917–18 (Breyer, J., dissenting). Vertical agreements issuing from new market entrants enable new entrants to gain a foothold while they build their product name and increase the possibility of greater inter-brand competition. *Id.* at 913.

should have sufficed for receiving rule of reason treatment rather than being declared per se illegal.[92]

III. Second Circuit's Reversion to Per Se Illegality for Vertical Agreements Creates Shaky Future for Antitrust Analysis

The U.S. Court of Appeals for the Second Circuit in 2015 in *United States v. Apple* ("*Apple II*") erred in applying per se illegality to Apple's agreements with the Publishing Defendants.[93] In identifying the agreements as vertical, the court should have applied the rule of reason analysis.[94] Additionally, the rule of reason analysis was appropriate given the novelty of the ebook industry.[95] This analysis would have brought any procompetitive justifications into consideration to offset the anticompetitive effects of the agreements.[96]

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[92] *See id.* at 917–18 (noting that exception to per se illegality may be necessary for new market entrants); *Apple II*, 791 F.3d at 330 (arguing that because Apple's contracts challenged Amazon's monopoly over ebooks, contracts enabled new retailers to enter ebook industry). As an alternative to per se illegality, Judge Livingston alone applied the abbreviated quick-look rule of reason. *Apple II*, 791 F.3d at 329–30; *see also* Cal. Dental Ass'n v. Fed. Trade Comm'n, 526 U.S. 756, 770 (1999) (holding that quick-look analysis appropriate for cases in which anticompetitive effects can "easily be ascertained"). Judge Livingston asserted that the immediate results of Apple's contracts on the ebook industry demonstrated the anticompetitive effects. *Apple II*, 791 F.3d at 329–30. Thus, a fuller inquiry was not necessary, but the quick-look approach enabled the court to consider Apple's procompetitive justifications. *Id.* at 329–30, 334. Despite considering Apple's justifications for creating price-setting contracts, Judge Livingston still believed that these agreements with the publishing companies constituted a violation of the Sherman Act. *Id.* at 330, 334–35.

[93] United States v. Apple, Inc. (*Apple II*), 791 F.3d 290, 322–25 (2d Cir. 2015), *cert. denied*, No. 15-565, 2016 WL 854227 (Mar. 7, 2016) (mem.); *see also* Wan Cha, *A New Post*-Leegin *Dilemma: Reconciliation of the Third Circuit's* Toledo Mack *Case and the Second Circuit's* Apple E-Books *Case*, 67 Rutgers U. L. Rev. 1547, 1589–90 (2015) (discussing how Second Circuit's decision created circuit split in determining when to apply per se or rule of reason if both horizontal and vertical agreements are involved); Jared Killeen, Note, *Throwing the E-Book at Publishers: What the Apple Case Tells Us About Antitrust Law*, 22 J. L. & Pol'y 341, 392 (2014) (arguing that district court in 2013 in *United States v. Apple, Inc.* should have applied rule of reason analysis and should have taken into consideration the novelty of the ebook industry and the procompetitive justifications).

[94] *See* Leegin Creative Leather Prods. v. PSKS, Inc., 551 U.S. 877, 893 (2007) (holding that vertical price agreements are analyzed under the rule of reason); *Apple II*, 791 F.3d at 323 (pointing out that Apple's contracts with Publishing Defendants were vertical agreements).

[95] *See* State Oil Co. v. Khan, 522 U.S. 3, 10 (1997) (noting that courts should apply rule of reason when unfamiliar with an industry); United States v. Topco Assocs., Inc., 405 U.S. 596, 607–08 (1972) (noting that courts must develop familiarity with business relationships before they can apply per se illegality).

[96] *See Leegin*, 551 U.S. at 913, 917–18 (Breyer, J., dissenting) (observing that vertical price agreements may result in procompetitive justifications such as new market entry or deterring free riding); Fed. Trade Comm'n v. Superior Court Trial Lawyers Ass'n, 493 U.S. 411, 430 (1990) (citing N. Pac. R.R. Co. v. United States, 356 U.S. 1, 5 (1958)) (noting that concerns for administrative efficiency lead the per se standard to avoid otherwise tedious market inquiry).

The court in *Apple II* should not have applied per se illegality to Apple's involvement in the conspiracy to raise and fix prices.[97] This characterization of Apple's contracts perpetuates the confusion regarding hub-and-spoke conspiracies.[98] In acknowledging that the contracts were vertical agreements, the Second Circuit should have followed the U.S. Supreme Court's 2007 decision in *Leegin Creative Leather Products v. PSKS, Inc.* and applied the rule of reason analysis to assess whether Apple's contracts violated Section 1 of the Sherman Act.[99] Instead, the Second Circuit focused on Apple's organization of the Publishing Defendants to raise and set ebook prices as the offensive conduct.[100]

Even though Apple facilitated the Publishing Defendants' horizontal conspiracy to raise prices, Apple's involvement was through its contracts.[101] The agency model of Apple's contracts enabled the Publishing Defendants to seize control of retail prices, but the contracts' price caps ensured that such prices were below a predetermined ceiling.[102] Additionally, with the MFN clause,

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[97] *Apple II*, 791 F.3d at 322–25; *see also* Cha, *supra* note 93, at 1552–79 (highlighting guidelines from *Leegin* as new economic framework by which courts should assess hub-and-spoke agreements before applying per se rule or rule of reason); Jennifer D. Lee, *Post* U.S. v. Apple*: How Should Most-Favored Nation Clauses Be Treated Now?*, 33 CARDOZO ARTS & ENT. L. J. 237, 255, 259 (2015) (noting that, in spite of Second Circuit's holding, MFN clauses should still be analyzed under the rule of reason).

[98] *See Apple II*, 791 F.3d at 324–25 (holding that Apple's vertical agreements with Publishing Defendants facilitated horizontal conspiracy); *see also* Total Benefits Planning Agency, Inc., v. Anthem Blue Cross & Blue Shield, 552 F.3d 430, 435–36 (6th Cir. 2008) (differentiating the hub-and-spoke arrangement at issue from the hub-and-spoke arrangement in *Toys "R" Us, Inc. v. Federal Trade Commission* based on the lack of a rim, or horizontal agreement, among the spokes).

[99] *See Leegin*, 551 U.S. at 893 (holding that rule of reason analysis applies even if vertical agreement establishing minimum resale prices promotes illegal horizontal agreement); Bus. Elec. Corp. v. Sharp Elec. Corp., 485 U.S. 717, 730–31 n.4 (1988) (holding restraint's arrangement, not its consequences, determines whether it is horizontal or vertical); *Apple II*, 791 F.3d at 323 (noting that rule of reason applicable standard for vertical agreement between manufacturers and distributors who fix prices). The U.S. Supreme Court in 1997 in *State Oil Co. v. Khan* had previously determined that vertical maximum price-fixing arrangements, which would include price caps, should be analyzed under the rule of reason. 522 U.S. at 17; *see also* Warren S. Grimes, *Making Sense of* State Oil Co. v. Khan*: Vertical Maximum Price Fixing Under a Rule of Reason*, 66 ANTITRUST L.J. 567, 598–99 (1998) (applying rule of reason to vertical maximum price-fixing agreements allows for safe harbor if the dealer has not incurred any sunk costs, a presumption of illegality if there are sunk costs, and an opportunity to rebut this presumption if the resale price ceiling is reasonably procompetitive); Roger D. Blair & John E. Lopatka, *The* Albrecht *Rule After* Khan*: Death Becomes Her*, 74 NOTRE DAME L. REV.123, 164 (1998) (arguing that, despite being a vague and costly standard, rule of reason should also be applied to horizontal agreements for price caps because per se rule fails to deter such conduct).

[100] *Apple II*, 791 F.3d at 323.

[101] *Id.* at 305, 308, 320 n.19; *see also* Toledo Mack Sales & Serv. v. Mack Trucks, Inc., 530 F.3d 204, 225 (3d Cir. 2008) ("[T]he rule of reason analysis 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."). Apple used its knowledge of the publishing companies' disdain for Amazon's $9.99 price standard as leverage for pushing through its own contracts. *Apple II*, 791 F.3d at 301–03.

[102] *Apple II*, 791 F.3d at 310–11.

Apple knew that the publishing companies would need to adopt agency models with all of their retailers.[103] Although these contracts facilitated the Publishing Defendants' desire to eliminate the $9.99 price standard, the contracts were still vertical agreements between Apple, as the retailer, and the Publishing Defendants, as the manufacturers.[104] The contracts should have been considered separately to determine the proper analysis, regardless of the hub-and-spoke context of the arrangements.[105]

Despite the immediate anticompetitive effects in publishing, per se illegality was inappropriate in *Apple II* given the novelty of both the ebook industry and the lack of jurisprudence for certain contractual provisions.[106] As the ebook industry was still relatively new and the court had not yet established knowledge of these business relationships, the Second Circuit should have applied the rule of reason.[107] The U.S. Supreme Court in *Leegin* acknowledged that new entrants should be provided an opportunity to justify their re-

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[103] *Id.* at 304–05.

[104] *See Bus. Elec.*, 485 U.S. at 730 (1988) (observing that horizontal agreements exist between competitors and vertical agreements exist between firms at different market levels); *Apple II*, 791 F.3d at 323 (noting that Apple's contracts with the Publishing Defendants constituted vertical agreements).

[105] *See Bus. Elec.*, 485 U.S. 730 n.4 (1988) (explaining that restraints are horizontal because of structure of arrangement, not because of resultant effects on market); *Total Benefits*, 552 F.3d at 435–36 (explaining that because hub-and-spoke conspiracy does not necessarily warrant per se rule, plaintiffs must allege horizontal relationship for an agreement to be per se unlawful); *see also* Mark A. Lemley & Christopher R. Leslie, *Categorical Analysis in Antitrust Jurisprudence*, 93 IOWA L. REV. 1207, 1219 (2008) (identifying whether an agreement is horizontal or vertical is critical because the agreements are assessed under different tests); Barak Orbach, *The Durability of Formalism in Antitrust*, 100 IOWA L. REV. 2197, 2214 (2015) (explaining that the distinction between horizontal and vertical agreements is "exceptionally important for antitrust analysis" but also that the distinction between good vertical agreements and bad horizontal agreements in hub-and-spoke context may be difficult to sustain). Both the rule of reason and the quick-look rule of reason, however, have received criticism in terms of their ability to regulate Sherman Act violations. *See* Feldman, *supra* note 23, at 595–97 (arguing that judicial efficiency of essential importance for antitrust analysis given breadth of economic inquiry); Maxwell M. Belcher, Schwinn*—An Example of a Genuine Commitment to Antitrust Law*, 44 ANTITRUST L.J. 550, 553 (1975) (explaining that rule of reason generally perceived as "euphemism for an endless economic inquiry resulting in a defense verdict"); *Leading Cases*, *supra* note 29, at 406 (noting that quick look provides defendants with opportunity to justify restraints but in practice defendants usually lose argument because of inherent anticompetitive effects).

[106] *See Leegin*, 551 U.S. at 913, 917–18 (Breyer, J., dissenting) (noting that vertical price agreements to fix prices can enable new parties to enter the market, rendering per se illegality potentially inappropriate); *Apple II*, 791 F.3d at 310 (discussing how ebook industry was both new and rapidly developing).

[107] *See Khan*, 522 U.S. at 10 (quoting Fed. Trade Comm'n v. Ind. Fed. of Dentists, 476 U.S. 447, 458–59 (1986)) (noting that court reluctant to apply per se illegality for those restraints when potential economic impact not immediately apparent); *Topco Assocs.*, 405 U.S. at 607–08 (holding that courts must attain familiarity with business relationships before per se rule can be applied). Amazon's Kindle had only been on the market for three years before Apple launched the iPad with the iBookstore feature. *Apple II*, 791 F.3d at 299, 301.

strictions.[108] Furthermore, though the Court in 1997 in *State Oil Co. v. Khan* found that vertical maximum price agreements, which include price caps, should be assessed under the rule of reason, neither the MFN clause nor the agency model was traditionally prosecuted as an antitrust violation.[109]

Just because this was a novel area and the contracts deserved a thorough analysis, however, does not excuse Apple from antitrust prosecution.[110] The contracts caused an increase in prices for both ebooks and physical books, and resulted in decreased output.[111] By giving the Publishing Defendants the ability to set prices and enforcing the MFN clause, Apple's contracts effectively eliminated retail price competition, which is a violation of Section 1 of the Sherman Act.[112] The U.S. District Court for the Southern District of New York and the Second Circuit should have assessed the contracts under the rule of reason to provide Apple, as both a new market entrant and a vertical player, the opportunity to justify its contracts in the novel area of ebook publishing.[113]

CONCLUSION

The Second Circuit's decision in *Apple II* demonstrates the confusion regarding hub-and-spoke conspiracies and whether any corresponding vertical agreements should be per se unlawful or analyzed under the rule of reason. In *Apple II,* the majority found that, even though Apple's contracts were vertical agreements, the contracts' facilitation of a horizontal conspiracy to raise prices was per se illegal. This decision contradicted the U.S. Supreme Court's decision in *Leegin,* which ruled that all vertical restraints should be analyzed

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[108] *See Leegin*, 551 U.S. at 891–92, 894 (explaining that resale price maintenance, including price caps, for new products or brands important for interbrand competition and to stimulate the economy). Significantly, the dissent in *Leegin* also agreed that new market entry might warrant further scrutiny. *Id.* at 917 (Breyer, J., dissenting).

[109] *Khan*, 522 U.S. at 17; *see* United States v. Gen. Electric Co., 272 U.S. 476, 488 (1926) (noting that agency contracts do not necessarily violate Sherman Act); Weiner, *supra* note 8, at 68 (observing that no court has found MFN clauses unlawful).

[110] *See Leegin*, 551 U.S. at 888 (holding that sufficient economic differences require treating horizontal and vertical agreements differently); *Bus. Elec.*, 485 U.S. at 730 (observing that horizontal restraints are formed between competitors at same market level and vertical restraints are formed between businesses at different market levels); *Apple II*, 791 F.3d at 329, 335 (noting that, despite Apple's innovative business arrangements, Apple's contracts still unreasonably restrained trade under the rule of reason analysis and, therefore, violated the Sherman Act).

[111] *Apple II*, 791 F.3d at 310–11.

[112] *Id.* at 297, 303, 310, 329.

[113] *See Leegin*, 551 U.S. at 893 (noting that vertical price agreements should be analyzed under rule of reason); *id.* at 917–18 (Breyer, J., dissenting) (discussing how restraints involving new market entry should possibly be considered under rule of reason); *Khan*, 522 U.S. at 17 (holding that vertical price fixing can be properly analyzed under the rule of reason); *see also* Lemley, *supra* note 105, at 1220 (explaining that after *Leegin*, all vertical price restraints subject to rule of reason analysis); Killeen, *supra* note 93, at 377–83 (discussing how uniqueness of ebook market should mandate rule of reason analysis).

through the rule of reason. In the future, courts should clarify whether vertical agreements embedded in hub-and-spoke conspiracies are separate or if they should be considered in the context of the rimmed conspiracy.

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