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ANTITRUST TRADE AND PRACTICE

Expert Analysis

Google, Antitrust And 'Change We Need'—but When?

By **Neal R. Stoll** And **Shepard Goldfein**

Barack Obama was carried to the presidency on the back of a dynamic campaign slogan: "The Change We Need." Regarding antitrust enforcement, we're still waiting for a significant event signaling a change in the Department of Justice's (DOJ) legal or economic policies relating to the application of the Sherman and Clayton Acts.

To date, the DOJ's antitrust policy pronouncements have been inconclusive. In May, the DOJ recanted the prior administration's report "Competition and Monopoly: Single-Firm Conduct Under Section 2 of the Sherman Act." In the DOJ's press release, Assistant Attorney General Christine Varney stated, "The recent developments in the marketplace should make it clear that we can no longer rely upon the marketplace alone to ensure that competition and consumers will be protected."[1]

Though Ms. Varney praised the effort behind the report and stated the decision to withdraw the report did not come easily, she sharply criticized it for creating too "many hurdles to Government antitrust enforcement."[2] Notwithstanding Ms. Varney's denouncement of the withdrawn DOJ single-firm policy statement, it is hard to discern what, if any, changes the DOJ has made regarding its position concerning the application of Section 2. Citing fundamental Supreme Court Section 2 decisions such as *Lorain Journal*[3] and *Aspen Skiing*,[4] Ms. Varney pledged the DOJ's commitment to "aggressively pursuing enforcement of Section 2 of the Sherman Act in furtherance of the principles embodied in these cases."[5] However, the DOJ's reliance on Section 2 precedents that recently have been severely marginalized by the Court would appear to be a short step off of a high cliff.

In any event, the DOJ has initiated a number of investigations involving firms (including exclusive distribution contracts between wireless phone service providers and smart phone manufacturers, IBM's sales of mainframe computers and Monsanto's seed sales) potentially possessing the requisite level of "market power" that could evolve into actionable "monopoly power." We'll just have to wait and see if any change in Section 2 enforcement policy flows from the pipeline.

The DOJ and the Federal Trade Commission (FTC) announced on Sept. 22 that they will solicit public comments and hold five joint workshops to consider updating the Horizontal Merger Guidelines. The workshops will seek to determine whether the guidelines (1) accurately and clearly describe current FTC and DOJ practices and (2) reflect advances in legal and economic theory that have occurred since the current guidelines were issued in 1992.

Meanwhile, we're still waiting for the DOJ to take a public position on the pending Ticketmaster- Live Nation merger. Announced in February 2009, it is curious that the DOJ hasn't announced whether it will challenge the transaction. Over the past eight months, the relevant legal precedents interpreting Section 7 of the Clayton Act haven't changed appreciably and are not expected to change imminently. Thus if it is "Change We Need" in antitrust merger enforcement, perhaps the DOJ should effect it sooner rather than later.

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'Author's Guild v. Google'

We do, however, have a translucent anecdotal window into the DOJ's future antitrust enforcement agenda. The DOJ has formally objected to the proposed settlement agreement in *The Author's Guild, et al. v. Google Inc.*[6] As a result of the DOJ's intercession, the parties announced that they are considering making some modifications to the proposed settlement. Also the district court judge hearing the matter has effectively informed the parties that the original settlement proposal will not be accepted. A hearing on the proposed settlement is scheduled for Nov. 9, 2009.

The DOJ's opposition to the settlement agreement shouldn't come as a surprise. At a panel discussion at the American Antitrust Institute's 10th Anniversary Conference in June of 2008, before her nomination or appointment as AAG, Ms. Varney stated, "For me, Microsoft is so last century. They are not the problem… [The U.S. economy will] continually see a problem—potentially with Google," as it has already "acquired a monopoly in Internet online advertising."[7]

Google, as we know it, may have Google Books to thank for its very origin. While computer science graduate students at Stanford University, Google founders Sergey Brin and Larry Page initially aspired to find a way to digitize libraries and create a search mechanism that would catalog the content of and analyze interconnections between library books. The mechanism they created, a Web crawler called "BackRub," provided the inspiration and foundation for the current algorithmic search mechanism that powers Google's current search engine.[8]

Nearly a decade and hundreds of millions of dollars later, that dream seems to be coming to fruition. Google has been able to scan and digitize over seven million books and provide varying levels of online access to those books. If the text is no longer protected by copyright, the entire book is available for online viewing or download. However, if a book is still under copyright, only "snippets," or three-four line text sections, are available unless the rights holder has opted out completely or consented to a broader display, such as certain pages or chapters.

On Sept. 20, 2005, the Author's Guild of America filed a class action lawsuit against Google in the Southern District of New York alleging copyright infringement and seeking injunctive and declaratory relief.[9] Shortly thereafter, the American Association of Publishers filed a similar suit on behalf of publishers against Google and the cases were consolidated. On Oct. 28, 2008, the parties entered into the settlement agreement.

The Settlement Agreement

The settlement agreement establishes several key terms of agreement between Google and the authors and publishers. Essentially, Google will receive a non-exclusive license to the copyrighted works and will acquire the right to continue to scan and digitize copyrighted works, display portions of those copyrighted works in response to user searches and queries, create and maintain an Institutional Subscription Database for use by entities such as university libraries, sell individual copyrighted works and place advertisements on the book pages online.

In return for these rights, Google Books will pay 63 percent of all revenues to the rights holders of the copyrighted works. Under the settlement agreement, Google will also pay a minimum of $45 million in "cash payments" to compensate the rights holders of copyrighted works it has already scanned prior to the opt-out date.[10]

NEAL R. STOLL *and* SHEPARD GOLDFEIN *are partners at Skadden, Arps, Slate, Meagher & Flom.* ANJALI B. PATEL, *an associate at the firm, assisted with the preparation of this column.*

The cash payments, as well as the split revenues paid by Google, will be paid to a Settlement Class Fund, to be administered by the Books Rights Registry (the Registry), an independent, not-for-profit collection entity created by the settlement agreement and authorized to act on behalf of rights holders of copyrighted works. Though an independent entity, the settlement agreement directs Google to initially fund the Registry with a one-time endowment of $34.5 million, which the Registry will use to cover its launch and initial administrative costs.[11]

Academics, scholars, industry experts and other interested persons have been debating the merits, effectiveness and ramifications of the settlement agreement for over a year. On Sept. 18, 2009, the DOJ filed objections to the proposed settlement agreement.[12] Though the DOJ's memorandum heaps high praise on the settlement agreement's good intentions, the DOJ raises serious antitrust concerns, even though the DOJ's preliminary stage investigation has raised considerable red flags only and no concrete decisions have been made.

The DOJ asserts that the settlement agreement facilitates horizontal price-fixing agreements and will restrict price competition in three ways: (1) at the wholesale level through an industry-wide revenue sharing agreement; (2) at the retail level through the implementation of a default price-setting mechanism and the elimination of discounting; and (3) through the control of orphan book pricing.

Concerning wholesalers, the DOJ posits that the settlement agreement will give publishers the power to act collectively and limit the price at which they will sell copyrighted works to distributors by fixing the royalty rate at 63 percent of Google's revenues.[13] By effectively setting a price floor, the DOJ claims that the fixed royalty rate will reduce incentives of an individual author or publisher to offer discounted or competitive terms to purchasers.

The DOJ also asserts that competition at the retail level is eliminated by the settlement agreement, as it requires that Google follow a detailed pricing algorithm to set default prices for copyrighted works that fall within the purview of the settlement agreement. The DOJ brands this practice as a "joint price-setting mechanism" and labels it per se illegal.

Furthermore, the DOJ argues that the settlement agreement discourages Google from offering discounts, as discounts must be authorized by both the Registry and the individual rights holder, constituting another per se violation of Section 1.

Finally, the DOJ argues that price competition is restricted through the settlement agreement's treatment of orphan works by allowing publishers, who already know the prices of competing books, to set the prices of orphan books.[14]

DOJ Concerns

The DOJ's per se label rejects the parties' argument that the proposed settlement creates a lawful joint venture similar to the one in question in *Broadcast Music Inc. v. Columbia Broadcast System*.[15] The DOJ argues that while Google may be offering a "new" product, Google will be acting as a joint sales agent allowing it to act in concert with publishers to set prices for books. The DOJ further distinguishes *BMI* by claiming that the settlement agreement allows publishers and authors to concertedly agree with Google, a distributor, on prices through a blanket license on revenues, rather than through individual revenue licensing agreements.[16]

The DOJ's second area of concern is that Google will have "de facto exclusive rights for the digital distribution of orphan works."[17] While the Registry will obtain the right to continue to license copyrighted works with the authorization of the individual rights holder, Google will effectively have a monopoly over the digitization of orphan works because the Registry will not be able to contact the rights holder in order to obtain authorization to license the work to another third-party.

Accordingly, a potential competitor would likely face a considerable burden to try to replicate the comprehensive database Google would have and, thus, be effectively foreclosed from the market.

The DOJ also states that potential competitors will be further discouraged from entering the market due to the "most favored nation" clause in the settlement agreement, as no competitor could obtain better terms than Google and, thus, would not be able to compete effectively against the incumbent. The DOJ concludes that the settlement agreement entrenches Google as the sole provider of a digital library and amounts to an antitrust violation.[18]

Horizontal Price Agreements

The DOJ's opposition has aggressively characterized the pricing arrangements created in the settlement agreements as "horizontal" price agreements. By grouping all authors together at the same level as publishers, the DOJ argues that the fixed royalty rate of 63 percent reduces individual ability to discount or engage in price competition. Citing cases such as *Goldfarb v. Va. State Bar*, the DOJ appears to blur the lines between an actual price floor and an administrative, negotiated decision to set a royalty rate.[19]

Nowhere in the settlement agreement's provision of the fixed royalty rate is a price floor discussed nor does a royalty rate automatically amount to a price floor. The DOJ has confused a provision for additional revenue as a price-setting mechanism. Individual publishers and authors still retain the right to price their works how they wish. Thus, the DOJ's discussion of the per se illegality is contrary to the Supreme Court decisions avoiding per se condemnation when facts suggest something other than "naked" price fixing.

By characterizing the agreement as "horizontal," the DOJ also avoids entirely the Supreme Court decision in *Leegin Creative Leather Products Inc. v. PSKS Inc*.[20] In *Leegin*, the Supreme Court lifted the per se ban on minimum vertical price restraints stating, "vertical price restraints can have procompetitive effects."[21] The settlement agreement, which provides terms of agreement between the creators of a product (effectively the manufacturers) and a distributor, creates a vertical rather than a horizontal relationship. Google is merely providing a medium for use, and any pricing terms between the two levels of suppliers should be analyzed as a vertical agreement under the rule of reason.

Furthermore, the DOJ incorrectly cites to a number of cases holding that a ban on discounting is per se illegal. The DOJ fails to acknowledge the fact that the limitation is not a complete prohibition, but rather a cap that is an acceptable outcome between two suppliers on the same supply chain if the restraint originates upstream. Consequently, the DOJ's analysis here is arguably a stretch.

Orphan Works

Finally, the DOJ asserts that the settlement agreement will give Google a monopoly in orphan works. The settlement agreement provides Google with a non-exclusive license to all copyrighted works, with approval of the rights holder. Simple enough, as another future digital distributor can negotiate for the same rights. However, Google has acquired access to orphan works without the express authorization of the absent rights holder. Similarly, a potential competitor would never be able to obtain authorization to orphan publications, and it would be nearly impossible for a potential competitor to amass the same collection as Google.

It will be especially telling to see how this issue is addressed by the settlement agreement proposed at the Nov. 9 fairness hearing. The last result the DOJ wants is to have the court find that it is in the public interest for Google to obtain a de facto monopoly regarding the digital distribution of orphan publications as a result of the settlement agreement's creation of otherwise unavailable digital output. Such a finding would render Google Book's monopoly as lawfully acquired and, absent subsequent unreasonable conduct, immune from attack under Section 2.

Conclusion

At bottom, the judiciary ultimately will determine whether change is needed concerning federal antitrust enforcement. Disavowing the prior administration's report on Section 2 doesn't eliminate the stare decisis underlying the report's conclusions. Unilaterally characterizing a pricing mechanism that is part of an output enhancing relationship between producers and distributors as per se unlawful runs counter to well-established judicial precedent and well-grounded public policy. Adopting a new paradigm for merger enforcement will not delegitimize the body of legal and economic merger analyses created over the past 20 years.

1. Press Release, United States Department of Justice, Justice Department Withdraws Report on Antitrust Monopoly Law (May 11, 2009) (http://www.usdoj.gov/atr/public/press_releases/2009/245710.pdf) at 1.
2. Christine A. Varney, Assistant Attorney General—Antitrust Division, United States Department of Justice, Remarks Prepared for the Center for American Progress: Vigorous Antitrust Enforcement in This Challenging Era (May 11, 2009), at 6.
3. *Lorain Journal Co. v. United States*, 342 U.S. 143 (1951).
4. *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585 (1985).
5. Id. at 14.
6. Settlement Agreement, *The Author's Guild, et. al. v. Google Inc.*, No. 05-CV-8136 (S.D.N.Y. Oct. 28, 2008) [hereinafter "settlement agreement"].
7 See James Rowley, "Antitrust Pick Varney Saw Google as Next Microsoft," BLOOMBERG, Feb. 17, 2009, http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aG9B5.J3Bl1w.
8. Google books, History of Google Books, available at http://books.google.com/googlebooks/history.html.
9. Complaint at 10-13, *The Author's Guild, et. al. v. Google Inc.*, No. 05-CV-8136 (S.D.N.Y. Sept. 20, 2005).
10. Settlement Agreement, supra note 4, at §§2.1(b), 5.1, Article XI.
11. Id. at §§2.1(c), 5.2.
12. Statement of Interest of the United States of America Regarding Proposed Class Settlement, *The Author's Guild, et. al. v. Google Inc.*, No. 05-CV-8136 (S.D.N.Y. Sept. 18, 2009) [hereinafter "Memorandum"].
13. Id. at 19 (referencing the settlement agreement at §2.1(a)).
14. Id. at 21-22.
15. *Broadcast Music Inc. v. Columbia Broadcast System Inc.*, 441 U.S. 1 (1979) [hereinafter BMI].
16. Memorandum, supra note 10, at 18-19.
17. Id. at 23.
18. Id. at 24-25 (referencing the settlement agreement at §3.8(a)).
19. Id. at 20 (citing *Goldfarb v. Va. State Bar*, 421 U.S. 771 (1975)).
20. *Leegin Creative Leather Products Inc. v. PSKS Inc.*, 551 U.S. 877 (2007) [hereinafter *Leegin*].
21. Id. at 877.

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