Session 1: Controlling Information: Property and Contracts

We will start by reading four cases which address tools available to a firm to control valuable information. The first, *International News Service v. Associated Press*, is a U.S. property law and unfair competition law classic arising in the context of World War I. The second case, *Levitt v. Yelp!*, looks at unfair competition law questions in a modern context. We then switch to contracts and contract formation. *ProCD v. Zeidenberg* looks at the use of contracts to control information flows while *Nguyen v. Barnes & Noble Inc.* looks at contract formation on the Internet.

International News Service v. Associated Press

248 U.S. 215 (1918)

Mr. Justice PITNEY delivered the opinion of the Court: The parties are competitors in the gathering and distribution of news and its publication for profit in newspapers throughout the United States. The Associated Press, which was complainant in the District Court, is a co-operative organization, incorporated under the Membership Corporations Law of the state of New York, its members being individuals who are either proprietors or representatives of about 950 daily newspapers published in all parts of the United States. *** Complainant gathers in all parts of the world, by means of various instrumentalities of its own, by exchange with its members, and by other appropriate means, news and intelligence of current and recent events of interest to newspaper readers and distributes it daily to its members for publication in their newspapers. The cost of the service, amounting approximately to $3,500,000 per annum, is assessed upon the members and becomes a part of their costs of operation, to be recouped, presumably with profit, through the publication of their several newspapers. Under complainant's by-laws each member agrees upon assuming membership that news received through complainant's service is received exclusively for publication in a particular newspaper, language, and place specified in the certificate of membership, that no other use of it shall be permitted, and that no member shall furnish or permit any one in his employ or connected with his newspaper to furnish any of complainant's news in advance of publication to any person not a member. And each member is required to gather the local news of his district and supply it to the Associated Press and to no one else.

Defendant is a corporation organized under the laws of the state of New Jersey, whose business is the gathering and selling of news to its customers and clients, consisting of newspapers published throughout the United States, under contracts by which they pay certain amounts at stated times for defendant's service. It has widespread news-gathering agencies; the cost of its operations amounts, it is said, to more than $2,000,000 per annum; and it serves about 400 newspapers located in the various cities of the United States and abroad, a few of which are represented, also, in the membership of the Associated Press.

The parties are in the keenest competition between themselves in the distribution of news throughout the United States; and so, as a rule, are the newspapers that they serve, in their several districts. ***

The only matter that has been argued before us is whether defendant may lawfully be restrained from appropriating news taken from bulletins issued by complainant or any of its members, or from newspapers published by them, for the purpose of selling it to defendant's clients. Complainant asserts that defendant's admitted course of conduct in this regard both violates complainant's property right in the news and constitutes unfair competition in business. And notwithstanding the case has proceeded only to the stage of a preliminary injunction, we have deemed it proper to consider the underlying questions, since they go to the very merits of the action and are presented upon facts that are not in dispute. As presented in argument, these questions are: (1) Whether there is any property in news; (2) Whether, if there be property in news collected for the purpose of being published, it survives the instant of its publication in the first newspaper to which it is communicated by the news-gatherer; and (3) whether defendant's admitted course of conduct in appropriating for commercial use matter taken from bulletins or early editions of Associated Press publications constitutes unfair competition in trade. ***

We need spend no time, however, upon the general question of property in news matter at common law, or the application of the copyright act, since it seems to us the case must turn upon the question of unfair competition in business. And, in our opinion, this does not depend upon any general right of property analogous to the common-law right of the proprietor of an unpublished work to prevent its publication without his consent; nor is it foreclosed by showing that the benefits of the copyright act have been waived. We are dealing here not with restrictions upon publication but with the very facilities and processes of publication. The peculiar value of news is in the spreading of it while it is fresh; and it is evident that a valuable property interest in the news, as news, cannot be maintained by keeping it secret. Besides, except for matters improperly disclosed, or published in breach of trust or confidence, or in violation of law, none of which is involved in this branch of the case, the news of current events may be regarded as common property. What we are concerned with is the business of making it known to the world, in which both parties to the present suit are engaged. *** The parties are competitors in this field; and, on fundamental principles, applicable here as elsewhere, when the rights or privileges of the one are liable to conflict with those of the other, each party is under a duty so to conduct its own business as not unnecessarily or unfairly to injure that of the other.

Obviously, the question of what is unfair competition in business must be determined with particular reference to the character and circumstances of the business. The question here is not so much the rights of either party as against the public but their rights as between themselves. And, although we may and do assume that neither party has any remaining property interest as against the public in uncopyrighted news matter after the moment of its first publication, it by no means follows that there is no remaining property interest in it as between themselves. *** The question here is not so much the rights of either party as against the public but their rights as between themselves. And, although we may and do assume that neither party has any remaining property interest as against the public in uncopyrighted news matter after the moment of its first publication, it by no means follows that there is no remaining property interest in it as between themselves. ***

Board of Trade v. Christie Grain & Stock Co., 198 U.S. 236, 250, related to the distribution of quotations of prices on dealings upon a board of trade, which were collected by plaintiff and communicated on confidential terms to numerous persons under a contract not to make them public. This court held that, apart from certain special objections that were overruled, plaintiff's collection of quotations was entitled to the protection of the law; that, like a trade secret, plaintiff might keep to itself the work done at its expense, and did not lose its right by communicating the result to persons, even if many, in confidential relations to itself, under a contract not to make it public; and that strangers should be restrained from getting at the knowledge by inducing a breach of trust. * * *

Defendant insists that when, with the sanction and approval of complainant, and as the result of the use of its news for the very purpose for which it is distributed, a portion of complainant's members communicate it to the general public by posting it upon bulletin boards so that all may read, or by issuing it to newspapers and distributing it indiscriminately, complainant no longer has the right to control the use to be made of it; that when it thus reaches the light of day it becomes the common possession of all to whom it is accessible; and that any purchaser of a newspaper has the right to communicate the intelligence which it contains to anybody and for any purpose, even for the purpose of selling it for profit to newspapers published for profit in competition with complainant's members.

The fault in the reasoning lies in applying as a test the right of the complainant as against the public, instead of considering the rights of complainant and defendant, competitors in business, as between themselves. The right of the purchaser of a single newspaper to spread knowledge of its contents gratuitously, for any legitimate purpose not unreasonably interfering with complainant's right to make merchandise of it, may be admitted; but to transmit that news for commercial use, in competition with complainant—which is what defendant has done and seeks to justify—is a very different matter. In doing this defendant, by its very act, admits that it is taking material that has been acquired by complainant as the result of organization and the expenditure of labor, skill, and money, and which is salable by complainant for money, and that defendant in appropriating it and selling it as its own is endeavoring to reap where it has not sown, and by disposing of it to newspapers that are competitors of complainant's members is appropriating to itself the harvest of those who have sown. Stripped of all disguises, the process amounts to an unauthorized interference with the normal operation of complainant's legitimate business precisely at the point where the profit is to be reaped, in order to divert a material portion of the profit from those who have earned it to those who have not; with special advantage to defendant in the competition because of the fact that it is not burdened with any part of the expense of gathering the news. The transaction speaks for itself and a court of equity ought not to hesitate long in characterizing it as unfair competition in business. ***

As to securing "tips" from a competing news agency the District Court (240 Fed. 991, 995), while not sanctioning the practice, found that both parties had adopted it in accordance with common business usage, in the belief that their conduct was technically lawful, and hence did not find in it any sufficient ground for attributing unclean hands to complainant. The Circuit Court of Appeals found that the tip habit, though discouraged by complainant, was "incurably journalistic," and that there was "no difficulty in discriminating between the utilization of tips and the bodily appropriation of another's labor in accumulating and stating information."

We are inclined to think a distinction may be drawn between the utilization of tips and the bodily appropriation of news matter, either in its original form or after rewriting and without independent investigation and verification; whatever may appear at the final hearing, the proofs as they now stand recognize such a distinction; both parties avowedly recognize the practice of taking tips, and neither party alleges it to be unlawful or to amount to unfair competition in business. ***

In the case before us, in the present state of the pleadings and proofs, we need go no further than to hold, as we do, that the admitted pursuit by complainant of the practice of taking news items published by defendant's subscribers as tips to be investigated, and, if verified, the result of the investigation to be sold—the practice having been followed by defendant also, and by news agencies generally—is not shown to be such as to constitute an unconscientious or inequitable attitude towards its adversary so as to fix upon complainant the taint of unclean hands, and debar it on this ground from the relief to which it is otherwise entitled. ***

Mr. Justice HOLMES, dissenting: *** When it comes from one of the great news collecting agencies like the Associated Press, the source generally is indicated, plainly importing that credit; and that such a representation is implied may be inferred with some confidence from the unwillingness of the defendant to give the credit and tell the truth. If the plaintiff produces the news at the same time that the defendant does, the defendant's presentation impliedly denies to the plaintiff the credit of collecting the facts and assumes that credit to the defendant. If the plaintiff is later in Western cities it naturally will be supposed to have obtained its information from the defendant. The falsehood is a little more subtle, the injury, a little more indirect, than in ordinary cases of unfair trade, but I think that the principle that condemns the one condemns the other. It is a question of how strong an infusion of fraud is necessary to turn a flavor into a poison. The does seems to me strong enough here to need a remedy from the law. But as, in my view, the only ground of complaint that can be recognized without legislation is the implied misstatement, it can be corrected by stating the truth; and a suitable acknowledgment of the source is all that the plaintiff can require. I think that within the limits recognized by the decision of the Court the defendant should be enjoined from publishing news obtained from the Associated Press for hours after publication by the plaintiff unless it gives express credit to the Associated Press; the number of hours and the form of acknowledgment to be settled by the District Court.

Mr. Justice BRANDEIS, dissenting: *** That competition is not unfair in a legal sense, merely because the profits gained are unearned, even if made at the expense of a rival, is shown by many cases besides those referred to above. He who follows the pioneer into a new market, or who engages in the manufacture of an article newly introduced by another, seeks profits due largely to the labor and expense of the first adventurer; but the law sanctions, indeed encourages, the pursuit. ***

The means by which the International News Service obtains news gathered by the Associated Press is also clearly unobjectionable. It is taken from papers bought in the open market or from bulletins publicly posted. *** The manner of use is likewise unobjectionable. No reference is made by word or by act to the Associated Press, either in transmitting the news to subscribers or by them in publishing it in their papers. Neither the International News Service nor its subscribers is gaining or seeking to gain in its business a benefit from the reputation of the Associated Press. They are merely using its product without making compensation. That they have a legal right to do, because the product is not property, and they do not stand in any relation to the Associated Press, either of contract or of trust, which otherwise precludes such use. The argument is not advanced by characterizing such taking and use a misappropriation.

It is also suggested that the fact that defendant does not refer to the Associated Press as the source of the news may furnish a basis for the relief. But the defendant and its subscribers, unlike members of the Associated Press, were under no contractual obligation to disclose the source of the news; and there is no rule of law requiring acknowledgment to be made where uncopyrighted matter is reproduced. ***

Nor is the use made by the International News Service of the information taken from papers or bulletins of Associated Press members legally objectionable by reason of the purpose for which it was employed. The acts here complained of were not done for the purpose of injuring the business of the Associated Press. Their purpose was not even to divert its trade, or to put it at a disadvantage by lessening defendant's necessary expenses. The purpose was merely to supply subscribers of the International News Service promptly with all available news. ***

Fifth. The great development of agencies now furnishing country-wide distribution of news, the vastness of our territory, and improvements in the means of transmitting intelligence, have made it possible for a news agency or newspapers to obtain, without paying compensation, the fruit of another's efforts and to use news so obtained gainfully in competition with the original collector. The injustice of such action is obvious. But to give relief against it would involve more than the application of existing rules of law to new facts. It would require the making of a new rule in analogy to existing ones. The unwritten law possesses capacity for growth; and has often satisfied new demands for justice by invoking analogies or by expanding a rule or principle. This process has been in the main wisely applied and should not be discontinued. Where the problem is relatively simple, as it is apt to be when private interests only are involved, it generally proves adequate. But with the increasing complexity of society, the public interest tends to become omnipresent; and the problems presented by new demands for justice cease to be simple. Then the creation or recognition by courts of a new private right may work serious injury to the general public, unless the boundaries of the right are definitely established and wisely guarded. In order to reconcile the new private right with the public interest, it may be necessary to prescribe limitations and rules for its enjoyment; and also to provide administrative machinery for enforcing the rules. It is largely for this reason that, in the effort to meet the many new demands for justice incident to a rapidly changing civilization, resort to legislation has latterly been had with increasing frequency.

The rule for which the plaintiff contends would effect an important extension of property rights and a corresponding curtailment of the free use of knowledge and of ideas; and the facts of this case admonish us of the danger involved in recognizing such a property right in news, without imposing upon news-gatherers corresponding obligations. A large majority of the newspapers and perhaps half the newspaper readers of the United States are dependent for their news of general interest upon agencies other than the Associated Press. The channel through which about 400 of these papers received, as the plaintiff alleges, "a large amount of news relating to the European war of the greatest importance and of intense interest to the newspaper reading public" was suddenly closed. The closing to the International News Service of these channels for foreign news (if they were closed) was due not to unwillingness on its part to pay the cost of collecting the news, but to the prohibitions imposed by foreign governments upon its securing news from their respective countries and from using cable or telegraph lines running therefrom. For aught that appears, this prohibition may have been wholly undeserved; and at all events the 400 papers and their readers may be assumed to have been innocent. For aught that appears, the International News Service may have sought then to secure temporarily by arrangement with the Associated Press the latter's foreign news service. For aught that appears, all of the 400 subscribers of the International News Service would gladly have then become members of the Associated Press, if they could have secured election thereto. It is possible, also, that a large part of the readers of these papers were so situated that they could not secure prompt access to papers served by the Associated Press. The prohibition of the foreign governments might as well have been extended to the channels through which news was supplied to the more than a thousand other daily papers in the United States not served by the Associated Press; and a large part of their readers may also be so located that they cannot procure prompt access to papers served by the Associated Press.

A Legislature, urged to enact a law by which one news agency or newspaper may prevent appropriation of the fruits of its labors by another, would consider such facts and possibilities and others which appropriate inquiry might disclose. Legislators might conclude that it was impossible to put an end to the obvious injustice involved in such appropriation of news, without opening the door to other evils, greater than that sought to be remedied. Such appears to have been the opinion of our Senate which reported unfavorably a bill to give news a few hours' protection; and which ratified, on February 15, 1911, the convention adopted at the Fourth International American Conference; and such was evidently the view also of the signatories to the International Copyright Union of November 13, 1908, as both these conventions expressly exclude news from copyright protection. ***

Or legislators dealing with the subject might conclude, that the right to news values should be protected to the extent of permitting recovery of damages for any unauthorized use, but that protection by injunction should be denied, just as courts of equity ordinarily refuse (perhaps in the interest of free speech) to restrain actionable libels, and for other reasons decline to protect by injunction mere political rights; and as Congress has prohibited courts from enjoining the illegal assessment or collection of federal taxes. If a Legislature concluded to recognize property in published news to the extent of permitting recovery at law, it might, with a view to making the remedy more certain and adequate, provide a fixed measure of damages, as in the case of copyright infringement.

Or again, a Legislature might conclude that it was unwise to recognize even so limited a property right in published news as that above indicated; but that a news agency should, on some conditions, be given full protection of its business; and to that end a remedy by injunction as well as one for damages should be granted, where news collected by it is gainfully used without permission. If a Legislature concluded (as at least one court has held, New York and Chicago Grain and Stock Exchange v. Board of Trade, 19 N.E. 855) that under certain circumstances news-gathering is a business affected with a public interest; it might declare that, in such cases, news should be protected against appropriation, only if the gatherer assumed the obligation of supplying it at reasonable rates and without discrimination, to all papers which applied therefor. If legislators reached that conclusion, they would probably go further, and prescribe the conditions under which and the extent to which the protection should be afforded; and they might also provide the administrative machinery necessary for insuring to the public, the press, and the news agencies, full enjoyment of the rights so conferred.

Courts are ill-equipped to make the investigations which should precede a determination of the limitations which should be set upon any property right in news or of the circumstances under which news gathered by a private agency should be deemed affected with a public interest. Courts would be powerless to prescribe the detailed regulations essential to full enjoyment of the rights conferred or to introduce the machinery required for enforcement of such regulations. Considerations such as these should lead us to decline to establish a new rule of law in the effort to redress a newly disclosed wrong, although the propriety of some remedy appears to be clear.

Levitt v. Yelp! Inc.

765 F.3d 1123 (9th Cir. 2014)

BERZON, Circuit Judge: Today, individuals can share their opinions with the entire world courtesy of a few taps on the keyboard. The appellee in this case, Yelp! Inc. ("Yelp"), provides an online forum on which its users express opinions as to services ranging from dog walkers to taco trucks.

The appellees, Boris Levitt, Cats and Dogs Animal Hospital, Inc. ("Cats and Dogs"), John Mercurio, and Dr. Tracy Chan, are small business owners (collectively, "the business owners") who allege that Yelp extorted or attempted to extort advertising payments from them by manipulating user reviews and penning negative reviews of their businesses. The business owners filed a class-action lawsuit against Yelp for violations of California's Unfair Competition Law ("UCL"), California Business & Professions Code § 17200 *et seq.,* civil extortion, and attempted civil extortion.

The district court dismissed the lawsuit for failure to state a claim. ***

I.

A. Yelp's Service

Yelp provides an online directory that allows registered users to post reviews and rank businesses on a scale of one to five stars. Based on these user rankings, Yelp then assigns businesses an overall "star" rating. Businesses cannot opt out of being listed on Yelp.

Not all user reviews submitted appear on a business's Yelp page or remain there after initially appearing. Reviews can be removed by the reviewer, removed by Yelp for violating Yelp's "Review Guidelines" or "Terms of Service," or removed by an automated filtering software maintained by Yelp. According to Yelp's website, its filtering system operates as follows:

> Th[e] system decides how established a particular reviewer is and whether a review will be shown based on the reviewer's involvement on Yelp. While this may seem unfair . . . this system is designed to protect both consumers and businesses alike from fake reviews (i.e., a malicious review from a competitor or a planted review from an employee). The process is entirely automated to avoid human bias, and it affects both positive and negative reviews. It's important to note that these reviews are not deleted (they are always shown on the reviewer's public profile) and may reappear on your business page in the future.

Yelp also offers businesses advertising opportunities on its website for $300 to $1200 per month. Purchasing advertising allows a business to: appear in advertisements displayed above Yelp search results and on related business pages; prevent competitors' advertisements from appearing on its Yelp page listing; enhance its page listing with photos; and promote a favorite review to the top of its page.

B. The Allegations Against Yelp

The business owners maintain that Yelp created negative reviews of their businesses and manipulated review and ratings content to induce them to purchase advertising through Yelp. They urge that Yelp has thereby violated the UCL through acts of extortion and, when not successful in inducing payments to Yelp, attempted extortion. They also allege separate causes of action for civil extortion and attempted civil extortion.

The business owners seek to represent two subclasses of businesses: those that declined to advertise with Yelp ("nonsponsors"), and those that have, at some point, purchased advertising ("sponsors"). They support their claims by alleging that "approximately 200 Yelp employees or individuals acting on behalf of Yelp have written reviews of businesses on Yelp" and that Yelp's Chief Executive Officer admitted to a New York Times reporter that Yelp has paid users to write reviews, although it does not do so directly anymore.

The Third Amended Complaint contains the following plaintiff-specific allegations: *** Dr. Tracy Chan, a dentist, stated that she received calls from a Yelp sales representative "offer[ing] her lots of benefits, such as the opportunity to keep Chan's business ratings high by hiding or burying bad reviews," if she advertised with Yelp. According to Chan, the sales representative stated that "although many Yelp reviews were manipulated by a computer system, Yelp employees also had the ability to remove reviews from a business's Yelp page."

Chan initially declined to purchase advertising from Yelp. Two or three days after doing so, "Yelp removed nine 5-star reviews" from her page, causing her overall rating to drop from five to three stars. Chan called Yelp to ask about the decline in her overall rating, and was told that "Yelp 'tweaks' the ratings every so often and that [Yelp] could help her if she signed up for advertising services with Yelp." Chan alleged that "Yelp removed positive reviews . . . as a threat to cause Chan to fear that if she did not purchase advertising . . . her business's overall star rating would stay low."

"[O]ut of fear of further manipulations," Chan signed an advertising contract with Yelp. According to Chan, just days after signing the contract, her "overall rating increased to 4 stars and various five star reviews were reinstated by Yelp." She believes the rating increase was the result of her agreeing to advertise with Yelp.

Several months later, a Yelp sales agent asked Chan whether she was interested in increasing her advertising purchase with Yelp. When Chan declined, she "noticed that her reviews were again declining." That same month, Chan cancelled her existing advertising contract with Yelp. Chan alleged that after she cancelled, "Yelp removed positive reviews . . . and replaced them with negative reviews . . . to cause Chan to fear that if she did not pay Yelp for advertising, Yelp would continue to remove positive reviews from her [page]."

Chan's overall rating fluctuated over the next year and a half. She attributed dips in her rating to specific interactions with Yelp. For example, Chan stated that Yelp "removed several positive reviews," prompting her to "post a negative review about Yelp's conduct" on her Yelp page. "Within two to three days," she alleged, Yelp removed more positive reviews, causing her overall rating to "[fall] to 3 stars." Over a year later, Chan alleged that her overall rating fell again, this time from four stars to three and a half stars, when "Yelp removed six positive reviews" from her page after she "posted a negative review about Yelp to her own website." Chan asserted that the removal of positive reviews was done "to induce [her] to pay for advertising and/or to discourage her from posting negative information about Yelp." ***

II.

The business owners maintain that Yelp attempted to extort and did extort advertising payments from them by wrongfully threatening them with economic loss. We hold that the business owners have failed to state a claim under California law on which relief can be granted. Accordingly, we do not address Yelp's defense of immunity under the CDA.

A. California's Unfair Competition Law

California's Unfair Competition Law prohibits "any unlawful, unfair or fraudulent business act or practice and unfair, deceptive, untrue or misleading advertising." Cal. Bus. & Prof. Code § 17200. "[I]t establishes three varieties of unfair competition acts or practices which are unlawful, or unfair, or fraudulent." *Cel-Tech Commc'ns, Inc. v. L.A. Cellular Tel. Co.*, 20 Cal.4th 163, 180 (1999) (internal quotation marks omitted).

In prohibiting "any unlawful" business practice, the UCL "borrows violations of other laws and treats them as unlawful practices that the unfair competition law makes independently actionable." *Id.* (internal quotation marks omitted). The business owners premise their "unlawful" UCL claim on Yelp's allegedly extortionate conduct.

Specifically, they allege that the following conduct amounts to extortion: (1) Yelp manipulating user-generated reviews to induce them to buy advertising; and (2) Yelp creating its own negative reviews of their businesses to induce them to buy advertising. They do not assert any claims based on failure to remove negative third-party reviews of their businesses.

We conclude, first, that Yelp's manipulation of user reviews, assuming it occurred, was not wrongful use of economic fear, and, second, that the business owners pled insufficient facts to make out a plausible claim that Yelp authored negative reviews of their businesses. Accordingly, we agree with the district court that these allegations do not support a claim for extortion.

B. Unlawful (Extortionate) Business Practices

We first consider whether the business owners have stated a claim of extortionate, and therefore unlawful, business practices under California's UCL.

1

The Hobbs Act defines extortion as "the obtaining of property from another, with his consent, induced by *wrongful* use of actual or threatened force, violence, or fear, or under color of official right." 18 U.S.C. § 1951(b)(2) (emphasis added). Threats of economic harm made to "obtain[] . . . property from another," *id.,* are not generally considered "wrongful," *id.,* where the alleged extortioner has a legitimate claim to the property obtained through such threats. Therefore, unless a person has a preexisting right to be free of the threatened economic harm, threatening economic harm to induce a person to pay for a legitimate service is not extortion.

Like the Hobbs Act, California law states that "[e]xtortion is the obtaining of property from another, with his consent . . . induced by a *wrongful* use of force or fear." Cal. Penal Code § 518 (emphasis added). California law also provides that "[f]ear, such as will constitute extortion, may be induced by a threat . . . [t]o do an *unlawful* injury to the person or property of the individual threatened," *id.* § 519(1) (emphasis added), "thus excluding fear induced by threat to do a lawful injury," *People v. Beggs*, 178 Cal. 79, 83 (1918). Accordingly, the elements of extortion under federal and California law are substantially the same. The plaintiffs here point to no pertinent distinctions between the federal and California statutes.

In sum, to state a claim of economic extortion under both federal and California law, a litigant must demonstrate either that he had a pre-existing right to be free from the threatened harm, or that the defendant had no right to seek payment for the service offered. Any less stringent standard would transform a wide variety of legally acceptable business dealings into extortion.

2

Given these stringent requirements, the business owners in this case failed sufficiently to allege that Yelp *wrongfully* threatened economic loss by manipulating user reviews.

To start, we note that there is no allegation that Yelp directly threatened economic harm if the business owners refused to purchase advertising packages from Yelp. While the lack of such express threats does not alone dispose of the extortion claims, it does make the business owners' case considerably more difficult. Absent explicit threats of economic harm, the business owners must allege sufficient facts to support the inference that Yelp "inten[ded] . . . to induce payment through the use of threats or the exploitation of [economic] fears," *United States v. Greger*, 716 F.2d 1275, 1278 (9th Cir. 1983).

We begin with Chan, who alleges that Yelp extorted her by removing positive reviews from her Yelp page. Chan asserts that she was deprived of the benefit of the positive reviews Yelp users posted to Yelp's website, and that, had she received the benefits of the positive reviews, they would have counteracted the negative reviews other users posted.

But Chan had no pre-existing right to have positive reviews appear on Yelp's website. She alleges no contractual right pursuant to which Yelp must publish positive reviews, nor does any law require Yelp to publish them. By withholding the benefit of these positive reviews, Yelp is withholding a benefit that Yelp makes possible and maintains. It has no obligation to do so, however. Chan does not, and could not successfully, maintain that removal of positive user-generated reviews, by itself, violates anything other than Yelp's own purported practice. "[W]hat [Yelp] may do in a certain event [Yelp] may threaten to do." *Rothman v. Vedder Park Management*, 912 F.2d 315, 318 (9th Cir. 1990). Moreover, Chan does not allege that the advertising Yelp sold her was a valueless sham, or that she was already entitled to the advertising privileges Yelp induced her to buy. We thus "deal with a very narrow subset of the potential universe of extortion cases: one involving solely the accusation of the wrongful use of economic fear where two private parties have engaged in a mutually beneficial exchange of property." *Brokerage Concepts, Inc. v. U.S. Healthcare, Inc.*, 140 F.3d 494, 525-26 (3d Cir. 1998).

As Chan alleges no independent barrier to the ratings manipulation of which she complains, and as there is no allegation that Yelp's advertising services are, objectively, worthless, any implicit threat by Yelp to remove positive reviews absent payment for advertising was not wrongful within the meaning of the extortion statutes.

This conclusion is not entirely the end of the matter, as Chan alleges that the ratings manipulation negatively affected her "business's reputation." But Chan does not connect her claim of reputational harm to a specific allegation of wrongful conduct. We note, too, that unlike the other business owners, Chan at one time had a contractual relationship with Yelp. It may be that by manipulating Chan's ratings to induce her to increase her advertising dollars, Yelp "breached [its] duties under the contract []." *Rennell v. Rowe,* 635 F.3d 1008, 1014 (7th Cir. 2011). "But those claims should be pursued through state-law theories of contract . . .—not [extortion]." *Id.*

Chan's pleadings thus fail to allege that deflation of her business's overall rating resulting from removing positive reviews constitutes "wrongful" conduct, and she therefore fails to state a claim of economic extortion. ***

The other brand of extortionate ratings manipulation the business owners allege is the re-posting of negative reviews and the placement of negative reviews at the top of the business owners' Yelp pages. Business owners Mercurio and Cats and Dogs bring these allegations. Here, too, however, Cats and Dogs and Mercurio have no claim that it is independently wrongful for Yelp to post and arrange actual user reviews on its website as it sees fit. The business owners may deem the posting or order of user reviews as a threat of economic harm, but it is not unlawful for Yelp to post and sequence the reviews. As Yelp has the right to charge for legitimate advertising services, the threat of economic harm that Yelp leveraged is, at most, hard bargaining. ***

For these reasons and the reasons explained in Part II.B of this opinion, we conclude that none of the business owners have stated a claim of "unlawful" conduct on the basis of extortion. We therefore affirm the dismissal of the separate claims of civil extortion and attempted civil extortion, as well.

D. The UCL "Unfair" Prong

"Each prong of the UCL is a separate and distinct theory of liability," and so "the 'unfair' practices prong offers [plaintiffs] an independent basis for relief." *Lozano v. AT&T Wireless Servs., Inc.*, 504 F.3d 718, 731 (9th Cir. 2007). At least with respect to business-competitor cases, to state a claim under the UCL's "unfair" prong the alleged unfairness must "be tethered to some legislatively declared policy or proof of some actual or threatened impact on competition." *Cel-Tech*, 20 Cal.4th at 186-87.

The business owners acknowledge that the *Cel-Tech* standard applies here. Although this case is not a suit involving "unfairness to the *defendant's* competitors," *Lozano*, 504 F.3d at 735 (emphasis added), as Yelp does not compete with the business owners, the crux of the business owners' complaint is that Yelp's conduct unfairly injures their economic interests to the benefit of other businesses who choose to advertise with Yelp.

In business-competitor claims, "the word 'unfair' . . . means conduct that threatens an incipient violation of an antitrust law, or violates the policy or spirit of one of those laws because its effects are comparable to or the same as a violation of the law, or otherwise significantly threatens or harms competition." *Cel-Tech*, 20 Cal.4th at 187. Under this standard, the business owners have not stated a claim that Yelp violated the UCL's prohibition of unfair business practices.

The business owners do not allege that Yelp violated any "legislatively declared policy" other than the prohibitions on extortion discussed above. For the reasons discussed, they have not pled facts sufficient to support an inference of extortion.

As to violations of antitrust principles, the business owners allege generally that Yelp's conduct "harms competition by favoring businesses that submit to Yelp's manipulative conduct and purchase advertising to the detriment of competing businesses that decline to purchase advertising." This very general allegation does not satisfy *Cel-Tech*'s requirement that the effect of Yelp's conduct amounts to a violation of antitrust laws "or otherwise significantly threatens or harms competition." *Id.*

For these reasons, we conclude that the UCL claim fails under the "unfair" prong, as well.

III.

The business owners' Third Amended Complaint fails to state a claim under California's unfair competition laws, and fails to sufficiently allege extortion or attempted extortion.

We emphasize that we are not holding that *no* cause of action exists that would cover conduct such as that alleged, if adequately pled. But for all the reasons noted, extortion is an exceedingly narrow concept as applied to fundamentally economic behavior. The business owners have not alleged a legal theory or plausible facts to support the theories they do argue.

The judgment of the district court is, accordingly, AFFIRMED.

ProCD, Inc. v. Zeidenberg

86 F.3d 1447 (7th Cir. 1996)

EASTERBROOK, Circuit Judge: Must buyers of computer software obey the terms of shrinkwrap licenses? The district court held not, for two reasons: first, they are not contracts because the licenses are inside the box rather than printed on the outside; second, federal law forbids enforcement even if the licenses are contracts. Parties and numerous amici curiae have briefed many other issues, but these are the only two that matter—and we disagree with the district judge's conclusion on each. Shrinkwrap licenses are enforceable unless their terms are objectionable on grounds applicable to contracts in general (for example, if they violate a rule of positive law, or if they are unconscionable). Because no one argues that the terms of the license at issue here are troublesome, we remand with instructions to enter judgment for the plaintiff.

I

ProCD, the plaintiff, has compiled information from more than 3,000 telephone directories into a computer database. We may assume that this database cannot be copyrighted, although it is more complex, contains more information (nine-digit zip codes and census industrial codes), is organized differently, and therefore is more original than the single alphabetical directory at issue in Feist Publications, Inc. v. Rural Telephone Service Co., 499 U.S. 340 (1991). ProCD sells a version of the database, called SelectPhone™, on CD-ROM discs. (CD-ROM means "compact disc—read only memory." The "shrinkwrap license" gets its name from the fact that retail software packages are covered in plastic or cellophane "shrinkwrap," and some vendors, though not ProCD, have written licenses that become effective as soon as the customer tears the wrapping from the package. Vendors prefer "end user license," but we use the more common term.) A proprietary method of compressing the data serves as effective encryption too. Customers decrypt and use the data with the aid of an application program that ProCD has written. This program, which is copyrighted, searches the database in response to users' criteria (such as "find all people named Tatum in Tennessee, plus all firms with 'Door Systems' in the corporate name"). The resulting lists (or, as ProCD prefers, "listings") can be read and manipulated by other software, such as word processing programs.

The database in SelectPhone™ cost more than $10 million to compile and is expensive to keep current. It is much more valuable to some users than to others. The combination of names, addresses, and SIC codes enables manufacturers to compile lists of potential customers. Manufacturers and retailers pay high prices to specialized information intermediaries for such mailing lists; ProCD offers a potentially cheaper alternative. People with nothing to sell could use the database as a substitute for calling long distance information, or as a way to look up old friends who have moved to unknown towns, or just as an electronic substitute for the local phone book. ProCD decided to engage in price discrimination, selling its database to the general public for personal use at a low price (approximately $150 for the set of five discs) while selling information to the trade for a higher price. It has adopted some intermediate strategies too: access to the SelectPhone™ database is available via the America Online service for the price America Online charges to its clients (approximately $3 per hour), but this service has been tailored to be useful only to the general public.

If ProCD had to recover all of its costs and make a profit by charging a single price—that is, if it could not charge more to commercial users than to the general public—it would have to raise the price substantially over $150. The ensuing reduction in sales would harm consumers who value the information at, say, $200. They get consumer surplus of $50 under the current arrangement but would cease to buy if the price rose substantially. If because of high elasticity of demand in the consumer segment of the market the only way to make a profit turned out to be a price attractive to commercial users alone, then all consumers would lose out—and so would the commercial clients, who would have to pay more for the listings because ProCD could not obtain any contribution toward costs from the consumer market.

To make price discrimination work, however, the seller must be able to control arbitrage. An air carrier sells tickets for less to vacationers than to business travelers, using advance purchase and Saturday-night-stay requirements to distinguish the categories. A producer of movies segments the market by time, releasing first to theaters, then to pay-per-view services, next to the videotape and laserdisc market, and finally to cable and commercial tv. Vendors of computer software have a harder task. Anyone can walk into a retail store and buy a box. Customers do not wear tags saying "commercial user" or "consumer user." Anyway, even a commercial-user-detector at the door would not work, because a consumer could buy the software and resell to a commercial user. That arbitrage would break down the price discrimination and drive up the minimum price at which ProCD would sell to anyone.

Instead of tinkering with the product and letting users sort themselves—for example, furnishing current data at a high price that would be attractive only to commercial customers, and two-year-old data at a low price—ProCD turned to the institution of contract. Every box containing its consumer product declares that the software comes with restrictions stated in an enclosed license. This license, which is encoded on the CD-ROM disks as well as printed in the manual, and which appears on a user's screen every time the software runs, limits use of the application program and listings to non-commercial purposes.

Matthew Zeidenberg bought a consumer package of SelectPhone™ in 1994 from a retail outlet in Madison, Wisconsin, but decided to ignore the license. He formed Silken Mountain Web Services, Inc., to resell the information in the SelectPhone™ database. The corporation makes the database available on the Internet to anyone willing to pay its price—which, needless to say, is less than ProCD charges its commercial customers. Zeidenberg has purchased two additional SelectPhone™ packages, each with an updated version of the database, and made the latest information available over the World Wide Web, for a price, through his corporation. ProCD filed this suit seeking an injunction against further dissemination that exceeds the rights specified in the licenses (identical in each of the three packages Zeidenberg purchased). The district court held the licenses ineffectual because their terms do not appear on the outside of the packages. The court added that the second and third licenses stand no different from the first, even though they are identical, because they might have been different, and a purchaser does not agree to—and cannot be bound by—terms that were secret at the time of purchase.

II

Following the district court, we treat the licenses as ordinary contracts accompanying the sale of products, and therefore as governed by the common law of contracts and the Uniform Commercial Code. Whether there are legal differences between "contracts" and "licenses" (which may matter under the copyright doctrine of first sale) is a subject for another day. Zeidenberg does not argue that Silken Mountain Web Services is free of any restrictions that apply to Zeidenberg himself, because any effort to treat the two parties as distinct would put Silken Mountain behind the eight ball on ProCD's argument that copying the application program onto its hard disk violates the copyright laws. Zeidenberg does argue, and the district court held, that placing the package of software on the shelf is an "offer," which the customer "accepts" by paying the asking price and leaving the store with the goods. In Wisconsin, as elsewhere, a contract includes only the terms on which the parties have agreed. One cannot agree to hidden terms, the judge concluded. So far, so good—but one of the terms to which Zeidenberg agreed by purchasing the software is that the transaction was subject to a license. Zeidenberg's position therefore must be that the printed terms on the outside of a box are the parties' contract—except for printed terms that refer to or incorporate other terms. But why would Wisconsin fetter the parties' choice in this way? Vendors can put the entire terms of a contract on the outside of a box only by using microscopic type, removing other information that buyers might find more useful (such as what the software does, and on which computers it works), or both. The "Read Me" file included with most software, describing system requirements and potential incompatibilities, may be equivalent to ten pages of type; warranties and license restrictions take still more space. Notice on the outside, terms on the inside, and a right to return the software for a refund if the terms are unacceptable (a right that the license expressly extends), may be a means of doing business valuable to buyers and sellers alike. Doubtless a state could forbid the use of standard contracts in the software business, but we do not think that Wisconsin has done so.

Transactions in which the exchange of money precedes the communication of detailed terms are common. Consider the purchase of insurance. The buyer goes to an agent, who explains the essentials (amount of coverage, number of years) and remits the premium to the home office, which sends back a policy. On the district judge's understanding, the terms of the policy are irrelevant because the insured paid before receiving them. Yet the device of payment, often with a "binder" (so that the insurance takes effect immediately even though the home office reserves the right to withdraw coverage later), in advance of the policy, serves buyers' interests by accelerating effectiveness and reducing transactions costs. Or consider the purchase of an airline ticket. The traveler calls the carrier or an agent, is quoted a price, reserves a seat, pays, and gets a ticket, in that order. The ticket contains elaborate terms, which the traveler can reject by canceling the reservation. To use the ticket is to accept the terms, even terms that in retrospect are disadvantageous. * * *

Next consider the software industry itself. Only a minority of sales take place over the counter, where there are boxes to peruse. A customer may place an order by phone in response to a line item in a catalog or a review in a magazine. Much software is ordered over the Internet by purchasers who have never seen a box. Increasingly software arrives by wire. There is no box; there is only a stream of electrons, a collection of information that includes data, an application program, instructions, many limitations ("MegaPixel 3.14159 cannot be used with BytePusher 2.718"), and the terms of sale. The user purchases a serial number, which activates the software's features. On Zeidenberg's arguments, these unboxed sales are unfettered by terms—so the seller has made a broad warranty and must pay consequential damages for any shortfalls in performance, two "promises" that if taken seriously would drive prices through the ceiling or return transactions to the horse-and-buggy age.

According to the district court, the UCC does not countenance the sequence of money now, terms later. (Wisconsin's version of the UCC does not differ from the Official Version in any material respect, so we use the regular numbering system. Wis. Stat. § 402.201 corresponds to UCC § 2-201, and other citations are easy to derive.) One of the court's reasons—that by proposing as part of the draft Article 2B a new UCC § 2-2203 that would explicitly validate standard-form user licenses, the American Law Institute and the National Conference of Commissioners on Uniform Laws have conceded the invalidity of shrinkwrap licenses under current law—depends on a faulty inference. To propose a change in a law's text is not necessarily to propose a change in the law's effect. New words may be designed to fortify the current rule with a more precise text that curtails uncertainty. To judge by the flux of law review articles discussing shrinkwrap licenses, uncertainty is much in need of reduction—although businesses seem to feel less uncertainty than do scholars, for only three cases (other than ours) touch on the subject, and none directly addresses it. See Step-Saver Data Systems, Inc. v. Wyse Technology, 939 F.2d 91 (3d Cir. 1991); Vault Corp. v. Quaid Software Ltd., 847 F.2d 255, 268-70 (5th Cir. 1988); Arizona Retail Systems, Inc. v. Software Link, Inc., 831 F.Supp. 759 (D. Ariz. 1993). As their titles suggest, these are not consumer transactions. *Step-Saver* is a battle-of-the-forms case, in which the parties exchange incompatible forms and a court must decide which prevails. Our case has only one form; UCC § 2-207 is irrelevant. *Vault* holds that Louisiana's special shrinkwrap-license statute is preempted by federal law, a question to which we return. And *Arizona Retail Systems* did not reach the question, because the court found that the buyer knew the terms of the license before purchasing the software.

What then does the current version of the UCC have to say? We think that the place to start is § 2-204(1): "A contract for sale of goods may be made in any manner sufficient to show agreement, including conduct by both parties which recognizes the existence of such a contract." A vendor, as master of the offer, may invite acceptance by conduct, and may propose limitations on the kind of conduct that constitutes acceptance. A buyer may accept by performing the acts the vendor proposes to treat as acceptance. And that is what happened. ProCD proposed a contract that a buyer would accept by using the software after having an opportunity to read the license at leisure. This Zeidenberg did. He had no choice, because the software splashed the license on the screen and would not let him proceed without indicating acceptance. So although the district judge was right to say that a contract can be, and often is, formed simply by paying the price and walking out of the store, the UCC permits contracts to be formed in other ways. ProCD proposed such a different way, and without protest Zeidenberg agreed. Ours is not a case in which a consumer opens a package to find an insert saying "you owe us an extra $10,000" and the seller files suit to collect. Any buyer finding such a demand can prevent formation of the contract by returning the package, as can any consumer who concludes that the terms of the license make the software worth less than the purchase price. Nothing in the UCC requires a seller to maximize the buyer's net gains.

*** In the end, the terms of the license are conceptually identical to the contents of the package. Just as no court would dream of saying that SelectPhone™ must contain 3,100 phone books rather than 3,000, or must have data no more than 30 days old, or must sell for $100 rather than $150—although any of these changes would be welcomed by the customer, if all other things were held constant—so, we believe, Wisconsin would not let the buyer pick and choose among terms. Terms of use are no less a part of "the product" than are the size of the database and the speed with which the software compiles listings. Competition among vendors, not judicial revision of a package's contents, is how consumers are protected in a market economy. ProCD has rivals, which may elect to compete by offering superior software, monthly updates, improved terms of use, lower price, or a better compromise among these elements. As we stressed above, adjusting terms in buyers' favor might help Matthew Zeidenberg today (he already has the software) but would lead to a response, such as a higher price, that might make consumers as a whole worse off. ***

REVERSED AND REMANDED.

Nguyen v. Barnes & Noble Inc.

763 F.3d 1171 (9th Cir. 2014)

NOONAN, Circuit Judge: Barnes & Noble, Inc. ("Barnes & Noble") appeals the district court's denial of its motion to compel arbitration against Kevin Khoa Nguyen ("Nguyen") pursuant to the arbitration agreement contained in its website's Terms of Use. In order to resolve the issue of arbitrability, we must address whether Nguyen, by merely using Barnes & Noble's website, agreed to be bound by the Terms of Use, even though Nguyen was never prompted to assent to the Terms of Use and never in fact read them. We agree with the district court that Barnes & Noble did not provide reasonable notice of its Terms of Use, and that Nguyen therefore did not unambiguously manifest assent to the arbitration provision contained therein.

We also agree with the district court that Nguyen is not equitably estopped from avoiding arbitration because he relied on the Terms of Use's choice of law provision.

We therefore affirm the district court's denial of Barnes & Noble's motion to compel arbitration and to stay court proceedings.

I. Background

A.

The underlying facts are not in dispute. Barnes & Noble is a national bookseller that owns and operates hundreds of bookstores as well as the website. In August 2011, Barnes & Noble, along with other retailers across the country, liquidated its inventory of discontinued Hewlett-Packard Touchpads ("Touchpads"), an unsuccessful competitor to Apple's iPad, by advertising a "fire sale" of Touchpads at a heavily discounted price. Acting quickly on the nationwide liquidation of Touchpads, Nguyen purchased two units on Barnes & Noble's website on August 21, 2011, and received an email confirming the transaction. The following day, Nguyen received another email informing him that his order had been cancelled due to unexpectedly high demand. Nguyen alleges that, as a result of "Barnes & Noble's representations, as well as the delay in informing him it would not honor the sale," he was "unable to obtain an HP Tablet during the liquidation period for the discounted price," and was "forced to rely on substitute tablet technology, which he subsequently purchased . . . [at] considerable expense."

B.

In April 2012, Nguyen filed this lawsuit in California Superior Court on behalf of himself and a putative class of consumers whose Touchpad orders had been cancelled, alleging that Barnes & Noble had engaged in deceptive business practices and false advertising in violation of both California and New York law. Barnes & Noble removed the action to federal court and moved to compel arbitration under the Federal Arbitration Act ("FAA"), arguing that Nguyen was bound by the arbitration agreement in the website's Terms of Use.

The website's Terms of Use are available via a "Terms of Use" hyperlink located in the bottom left-hand corner of every page on the Barnes & Noble website, which appears alongside other hyperlinks labeled "NOOK Store Terms," "Copyright," and "Privacy Policy." These hyperlinks also appear underlined and set in green typeface in the lower lefthand corner of every page in the online checkout process.

Nguyen neither clicked on the "Terms of Use" hyperlink nor actually read the Terms of Use. Had he clicked on the hyperlink, he would have been taken to a page containing the full text of Barnes & Noble's Terms of Use, which state, in relevant part: "By visiting any area in the Barnes & Noble.com Site, creating an account, [or] making a purchase via the Barnes & Noble.com Site . . . a User is deemed to have accepted the Terms of Use." Nguyen also would have come across an arbitration provision, which states:

> XVIII. DISPUTE RESOLUTION
>
> Any claim or controversy at law or equity that arises out of the Terms of Use, the Barnes & Noble.com Site or any Barnes & Noble.com Service (each a "Claim"), shall be resolved through binding arbitration conducted by telephone, online or based solely upon written submissions where no in-person appearance is required. In such cases, arbitration shall be administered by the American Arbitration Association under its Commercial Arbitration Rules (including without limitation the Supplementary Procedures for Consumer-Related Disputes, if applicable), and judgment on the award rendered by the arbitrator(s) may be entered in any court having jurisdiction thereof. ***

Nguyen contends that he cannot be bound to the arbitration provision because he neither had notice of nor assented to the website's Terms of Use. Barnes & Noble, for its part, asserts that the placement of the "Terms of Use" hyperlink on its website put Nguyen on constructive notice of the arbitration agreement. Barnes & Noble contends that this notice, combined with Nguyen's subsequent use of the website, was enough to bind him to the Terms of Use. The district court disagreed, and Barnes & Noble now appeals. ***

III. Discussion

A.

*** Here, the parties agree that the validity of the arbitration agreement is governed by New York law, as specified by the Terms of Use's choice of law provision. But whether the choice of law provision applies depends on whether the parties agreed to be bound by Barnes & Noble's Terms of Use in the first place. As the district court acknowledged in its order, we need not engage in this circular inquiry because both California and New York law dictate the same outcome. Thus, in evaluating the validity of Barnes & Noble's arbitration agreement, we apply New York law, to the extent possible.

For the reasons that follow, we hold that Nguyen did not enter into Barnes & Noble's agreement to arbitrate.

B.

"While new commerce on the Internet has exposed courts to many new situations, it has not fundamentally changed the principles of contract." *Register.com, Inc. v. Verio, Inc.*, 356 F.3d 393, 403 (2d Cir. 2004). One such principle is the requirement that "[m]utual manifestation of assent, whether by written or spoken word or by conduct, is the touchstone of contract."

Specht v. Netscape Commc'ns Corp., 306 F.3d 17, 29 (2d Cir. 2002) (applying California law).

Contracts formed on the Internet come primarily in two flavors: "clickwrap" (or "click-through") agreements, in which website users are required to click on an "I agree" box after being presented with a list of terms and conditions of use; and "browsewrap" agreements, where a website's terms and conditions of use are generally posted on the website via a hyperlink at the bottom of the screen. Barnes & Noble's Terms of Use fall in the latter category. ***

Were there any evidence in the record that Nguyen had actual notice of the Terms of Use or was required to affirmatively acknowledge the Terms of Use before completing his online purchase, the outcome of this case might be different. Indeed, courts have consistently enforced browsewrap agreements where the user had actual notice of the agreement. Courts have also been more willing to find the requisite notice for constructive assent where the browsewrap agreement resembles a clickwrap agreement—that is, where the user is required to affirmatively acknowledge the agreement before proceeding with use of the website.

But where, as here, there is no evidence that the website user had actual knowledge of the agreement, the validity of the browsewrap agreement turns on whether the website puts a reasonably prudent user on inquiry notice of the terms of the contract. Whether a user has inquiry notice of a browsewrap agreement, in turn, depends on the design and content of the website and the agreement's webpage. Where the link to a website's terms of use is buried at the bottom of the page or tucked away in obscure corners of the website where users are unlikely to see it, courts have refused to enforce the browsewrap agreement. On the other hand, where the website contains an explicit textual notice that continued use will act as a manifestation of the user's intent to be bound, courts have been more amenable to enforcing browsewrap agreements. In short, the conspicuousness and placement of the "Terms of Use" hyperlink, other notices given to users of the terms of use, and the website's general design all contribute to whether a reasonably prudent user would have inquiry notice of a browsewrap agreement.

Barnes & Noble argues that the placement of the "Terms of Use" hyperlink in the bottom left-hand corner of every page on the Barnes & Noble website, and its close proximity to the buttons a user must click on to complete an online purchase, is enough to place a reasonably prudent user on constructive notice. ***

But the proximity or conspicuousness of the hyperlink alone is not enough to give rise to constructive notice, and Barnes & Noble directs us to no case law that supports this proposition. *** In light of the lack of controlling authority on point, and in keeping with courts' traditional reluctance to enforce browsewrap agreements against individual consumers, we therefore hold that where a website makes its terms of use available via a conspicuous hyperlink on every page of the website but otherwise provides no notice to users nor prompts them to take any affirmative action to demonstrate assent, even close proximity of the hyperlink to relevant buttons users must click on—without more—is insufficient to give rise to constructive notice. While failure to read a contract before agreeing to its terms does not relieve a party of its obligations under the contract, the onus must be on website owners to put users on notice of the terms to which they wish to bind consumers. Given the breadth of the range of technological savvy of online purchasers, consumers cannot be expected to ferret out hyperlinks to terms and conditions to which they have no reason to suspect they will be bound. ***

We hold that Nguyen had insufficient notice of Barnes & Noble's Terms of Use, and thus did not enter into an agreement with Barnes & Noble to arbitrate his claims.

AFFIRMED.

Clicks and More

In many cases, a firm spends substantial resources to create information and then wants to distribute that information. The ease with which information can be copied means that distributing the information creates the possibility of building a competitor to the firm that initially distributed the information. Firms typically want less competition, not more, so they have strong incentives to try to minimize the ability of other firms to redistribute that information, especially if that redistribution puts at risk their business model. This is a frequent issue for firms. To see this issue in three other settings, click on the links that follow (1) *National Basketball Ass'n v. Motorola, Inc.*, 105 F.3d 841 (2nd Cir. 1997); (2) *Barclays Capital Inc. v. theflyonthewall.com, Inc.*, 650 F.3d 876 (2nd Cir. 2011); and (3) Yelp Terms of Service (update of November 27, 2012).

There are many other issues that arise in connection with the monetization of information. Start with what information economists call "versioning." Versioning occurs when a firm takes a product and figures out a way to turn it into multiple products targeted at different customer bases. Starting in 1946, the University of Michigan has surveyed consumers to understand their current views of the United States economy. (For background, see Surveys of Consumers.) Over time, the consumer sentiment survey has become valuable information and that has led to a two-tier structure for the release of updates to the survey. As *The Wall Street Journal* reported on June 12, 2013 (possibly paywalled story here), Thomson Reuters struck a deal to pay Michigan for early access to the to-be-announced consumer results with Thomson paying $1.1 million for the early look in 2013 and $1.2 million in 2014. Thomson in turn has created two early-look products based on the Michigan data. One product gives buying firms fast access at 9:54:58 a.m. Eastern time; the second gives other Thomson customers access two seconds later. Michigan posts the data on its website, available to the public for free, five minutes later at 10 a.m. These practices raise a number of questions. Consider the views, quoted in the WSJ story, of former White House ethics lawyer Richard Painter that entities like the University of Michigan and Thomson Reuters should "not be allowed to selectively disclose market-moving data to people who pay more money—that is not right."

Switch to government information. As students of the 1983 Dan Aykroyd and Eddie Murphy classic *Trading Places* will know, the United States government has its own valuable data sources and early access to that information can be valuable. The film is all about gaining early access to an orange juice forecast by the U.S. Department of Agriculture and those forecasts remain important to traders today. Stealing that information is undoubtedly a federal crime, but other firms have figured out other ways to get early information.

It isn't unusual for private firms distributing press-worthy information to distribute it to the press in advance subject to an embargo on the release of stories based on that information. Some government agencies, including the U.S. Department of Labor, have done the same thing, but given the sensitivity of the government information and the capacity of that information to move markets, the government has moved to tighter controls over its early access program. That includes separating out general news organizations from firms seeking press credentials to facilitate their ability to build early-release trading products. These products are based on speed—low latency by design—and for high-speed computerized algorithmic trading. (For information, see Deutsche Börse's AlphaFlash product and news stories (*NYT*, July 16, 2012 and *WSJ*, August 12, 2013.))

Consider one more situation that raises a different question: to what extent should a firm limit its own internal use of information? Bloomberg LP has emerged as leading provider of real-time data access with its ubiquitous and expensive data terminals. But Bloomberg has also become a substantial financial news organization. In early May, 2013, it was reported that Bloomberg news reporters had had access to information regarding Bloomberg customer use of their Bloomberg data terminals. JP Morgan quickly asked Bloomberg for a detailed investigation into what JP Morgan considered a breach of the conditions under which it used the data terminals. Bloomberg ultimately responded with two external investigations and promised new controls going forward.

Session 2: Intellectual Property

We will discuss the leading varieties of intellectual property such as copyright, trade secrets, trademarks, the right of publicity and patents. In the U.S., intellectual property law is a mix of state and federal law and federal law is founded upon Article I, Section 8, Clause 8 of the U.S. Constitution: "The Congress shall have the Power . . . . [t]o promote the progress of science and useful arts, by securing for limited times to authors and inventors the exclusive right to their respective writings and discoveries; … ."

Each of these areas has important live issues right now and we will try to touch on each of these in class. We will start by reading a 2015 decision that shows the ways in which technological changes can create new business opportuntieis and then we will look an important 2014 U.S. Supreme Court patent case, *Alice Corp. Pty. Ltd. v. CLS Bank International*.

Authors Guild v. Google, Inc.

804 F.3d 202 (2nd Cir. 2015)

LEVAL, Circuit Judge: This copyright dispute tests the boundaries of fair use. Plaintiffs, who are authors of published books under copyright, sued Google, Inc. ("Google") for copyright infringement in the United States District Court for the Southern District of New York (Chin, J.). They appeal from the grant of summary judgment in Google's favor. Through its Library Project and its Google Books project, acting without permission of rights holders, Google has made digital copies of tens of millions of books, including Plaintiffs', that were submitted to it for that purpose by major libraries. Google has scanned the digital copies and established a publicly available search function. An Internet user can use this function to search without charge to determine whether the book contains a specified word or term and also see "snippets" of text containing the searched-for terms. In addition, Google has allowed the participating libraries to download and retain digital copies of the books they submit, under agreements which commit the libraries not to use their digital copies in violation of the copyright laws. These activities of Google are alleged to constitute infringement of Plaintiffs' copyrights. Plaintiffs sought injunctive and declaratory relief as well as damages.

Google defended on the ground that its actions constitute "fair use," which, under 17 U.S.C. § 107, is "not an infringement." The district court agreed. *Authors Guild, Inc. v. Google Inc.*, 954 F.Supp.2d 282, 294 (S.D.N.Y. 2013). Plaintiffs brought this appeal.

Plaintiffs contend the district court's ruling was flawed in several respects. They argue: (1) Google's digital copying of entire books, allowing users through the snippet function to read portions, is not a "transformative use" within the meaning of *Campbell v. Acuff-Rose Music, Inc.*, 510 U.S. 569, 578-585 (1994), and provides a substitute for Plaintiffs' works; (2) notwithstanding that Google provides public access to the search and snippet functions without charge and without advertising, its ultimate commercial profit motivation and its derivation of revenue from its dominance of the world-wide Internet search market to which the books project contributes, preclude a finding of fair use; (3) even if Google's copying and revelations of text do not infringe plaintiffs' books, they infringe Plaintiffs' derivative rights in search functions, depriving Plaintiffs of revenues or other benefits they would gain from licensed search markets; (4) Google's storage of digital copies exposes Plaintiffs to the risk that hackers will make their books freely (or cheaply) available on the Internet, destroying the value of their copyrights; and (5) Google's distribution of digital copies to participant libraries is not a transformative use, and it subjects Plaintiffs to the risk of loss of copyright revenues through access allowed by libraries. We reject these arguments and conclude that the district court correctly sustained Google's fair use defense.

Google's making of a digital copy to provide a search function is a transformative use, which augments public knowledge by making available information about Plaintiffs' books without providing the public with a substantial substitute for matter protected by the Plaintiffs' copyright interests in the original works or derivatives of them. The same is true, at least under present conditions, of Google's provision of the snippet function. Plaintiffs' contention that Google has usurped their opportunity to access paid and unpaid licensing markets for substantially the same functions that Google provides fails, in part because the licensing markets in fact involve very different functions than those that Google provides, and in part because an author's derivative rights do not include an exclusive right to supply information (of the sort provided by Google) about her works. Google's profit motivation does not in these circumstances justify denial of fair use. Google's program does not, at this time and on the record before us, expose Plaintiffs to an unreasonable risk of loss of copyright value through incursions of hackers. Finally, Google's provision of digital copies to participating libraries, authorizing them to make non-infringing uses, is non-infringing, and the mere speculative possibility that the libraries might allow use of their copies in an infringing manner does not make Google a contributory infringer. Plaintiffs have failed to show a material issue of fact in dispute.

We affirm the judgment.

BACKGROUND

I. Plaintiffs

The author-plaintiffs are Jim Bouton, author of *Ball Four*; Betty Miles, author of *The Trouble with Thirteen*; and Joseph Goulden, author of *The Superlawyers: The Small and Powerful World of the Great Washington Law Firms*. Each of them has a legal or beneficial ownership in the copyright for his or her book. Their books have been scanned without their permission by Google, which made them available to Internet users for search and snippet view on Google's website.

II. Google Books and the Google Library Project

Google's Library Project, which began in 2004, involves bi-lateral agreements between Google and a number of the world's major research libraries. Under these agreements, the participating libraries select books from their collections to submit to Google for inclusion in the project. Google makes a digital scan of each book, extracts a machine-readable text, and creates an index of the machine-readable text of each book. Google retains the original scanned image of each book, in part so as to improve the accuracy of the machine-readable texts and indices as image-to-text conversion technologies improve.

Since 2004, Google has scanned, rendered machine-readable, and indexed more than 20 million books, including both copyrighted works and works in the public domain. The vast majority of the books are non-fiction, and most are out of print. All of the digital information created by Google in the process is stored on servers protected by the same security systems Google uses to shield its own confidential information.

The digital corpus created by the scanning of these millions of books enables the Google Books search engine. Members of the public who access the Google Books website can enter search words or terms of their own choice, receiving in response a list of all books in the database in which those terms appear, as well as the number of times the term appears in each book. A brief description of each book, entitled "About the Book," gives some rudimentary additional information, including a list of the words and terms that appear with most frequency in the book. It sometimes provides links to buy the book online and identifies libraries where the book can be found. The search tool permits a researcher to identify those books, out of millions, that do, as well as those that do not, use the terms selected by the researcher. Google notes that this identifying information instantaneously supplied would otherwise not be obtainable in lifetimes of searching.

No advertising is displayed to a user of the search function. Nor does Google receive payment by reason of the searcher's use of Google's link to purchase the book.

The search engine also makes possible new forms of research, known as "text mining" and "data mining." Google's "ngrams" research tool draws on the Google Library Project corpus to furnish statistical information to Internet users about the frequency of word and phrase usage over centuries. This tool permits users to discern fluctuations of interest in a particular subject over time and space by showing increases and decreases in the frequency of reference and usage in different periods and different linguistic regions. It also allows researchers to comb over the tens of millions of books Google has scanned in order to examine "word frequencies, syntactic patterns, and thematic markers" and to derive information on how nomenclature, linguistic usage, and literary style have changed over time. *Authors Guild, Inc.*, 954 F.Supp.2d at 287. The district court gave as an example "track[ing] the frequency of references to the United States as a single entity ('the United States is') versus references to the United States in the plural ('the United States are') and how that usage has changed over time." Id.

The Google Books search function also allows the user a limited viewing of text. In addition to telling the number of times the word or term selected by the searcher appears in the book, the search function will display a maximum of three "snippets" containing it. A snippet is a horizontal segment comprising ordinarily an eighth of a page. Each page of a conventionally formatted book in the Google Books database is divided into eight non-overlapping horizontal segments, each such horizontal segment being a snippet. (Thus, for such a book with 24 lines to a page, each snippet is comprised of three lines of text.) Each search for a particular word or term within a book will reveal the same three snippets, regardless of the number of computers from which the search is launched. Only the first usage of the term on a given page is displayed. Thus, if the top snippet of a page contains two (or more) words for which the user searches, and Google's program is fixed to reveal that particular snippet in response to a search for either term, the second search will duplicate the snippet already revealed by the first search, rather than moving to reveal a different snippet containing the word because the first snippet was already revealed. Google's program does not allow a searcher to increase the number of snippets revealed by repeated entry of the same search term or by entering searches from different computers. A searcher can view more than three snippets of a book by entering additional searches for different terms. However, Google makes permanently unavailable for snippet view one snippet on each page and one complete page out of every ten—a process Google calls "blacklisting."

Google also disables snippet view entirely for types of books for which a single snippet is likely to satisfy the searcher's present need for the book, such as dictionaries, cookbooks, and books of short poems. Finally, since 2005, Google will exclude any book altogether from snippet view at the request of the rights holder by the submission of an online form.

Under its contracts with the participating libraries, Google allows each library to download copies—of both the digital image and machine-readable versions—of the books that library submitted to Google for scanning (but not of books submitted by other libraries). This is done by giving each participating library access to the Google Return Interface ("GRIN"). The agreements between Google and the libraries, although not in all respects uniform, require the libraries to abide by copyright law in utilizing the digital copies they download and to take precautions to prevent dissemination of their digital copies to the public at large. Through the GRIN facility, participant libraries have downloaded at least 2.7 million digital copies of their own volumes.

III. Procedural History

*** On November 14, 2013, the district court granted Google's motion for summary judgment, concluding that the uses made by Google of copyrighted books were fair uses, protected by § 107. *Authors Guild*, 954 F.Supp.2d at 284. Upon consideration of the four statutory factors of § 107, the district court found that Google's uses were transformative, that its display of copyrighted material was properly limited, and that the Google Books program did not impermissibly serve as a market substitute for the original works. Id. at 290. The court entered judgment initially on November 27, 2013, followed by an amended judgment on December 10, 2013, dismissing Plaintiffs' claims with prejudice. Plaintiffs filed timely notice of appeal.

DISCUSSION

I. The Law of Fair Use

The ultimate goal of copyright is to expand public knowledge and understanding, which copyright seeks to achieve by giving potential creators exclusive control over copying of their works, thus giving them a financial incentive to create informative, intellectually enriching works for public consumption. This objective is clearly reflected in the Constitution's empowerment of Congress "*To promote the Progress of Science* ... by securing for limited Times to Authors ... the exclusive Right to their respective Writings." U.S. Const., Art. I, § 8, cl. 8 (emphasis added). Thus, while authors are undoubtedly important intended beneficiaries of copyright, the ultimate, primary intended beneficiary is the public, whose access to knowledge copyright seeks to advance by providing rewards for authorship.

For nearly three hundred years, since shortly after the birth of copyright in England in 1710, courts have recognized that, in certain circumstances, giving authorsabsolute control over all copying from their works would tend in some circumstances to limit, rather than expand, public knowledge. In the words of Lord Ellenborough, "[W]hile I shall think myself bound to secure every man in the enjoyment of his copy-right, one must not put manacles upon science." *Cary v. Kearsley*, Cary v. Kearsley, 170 Eng. Rep. 679, 681(1802). Courts thus developed the doctrine, eventually named fair use, which permits unauthorized copying in some circumstances, so as to further "copyright's very purpose, '[t]o promote the Progress of Science and useful Arts.'" *Campbell v. Acuff-Rose Music, Inc.*, Campbell v. Acuff-Rose Music, Inc., 510 U.S. 569, 575 (1994) (quoting U.S. Const., Art. I, § 8, cl. 8). Although well established in the common law development of copyright, fair use was not recognized in the terms of our statute until the adoption of § 107 in the Copyright Act of 1976. 17 U.S.C. §§ 101 et seq.

Section 107, in its present form, provides:

> [T]he fair use of a copyrighted work ... for purposes such as criticism, comment, news reporting, teaching (including multiple copies for classroom use), scholarship, or research, is not an infringement of copyright. In determining whether the use made of a work in any particular case is a fair use the factors to be considered shall include —
>
> (1) the purpose and character of the use, including whether such use is of a commercial nature or is for nonprofit educational purposes;
>
> (2) the nature of the copyrighted work;
>
> (3) the amount and substantiality of the portion used in relation to the copyrighted work as a whole; and
>
> (4) the effect of the use upon the potential market for or value of the copyrighted work.
>
> The fact that a work is unpublished shall not itself bar a finding of fair use if such finding is made upon consideration of all the above factors.

17 U.S.C. § 107. As the Supreme Court has designated fair use an affirmative defense, see *Campbell*, 510 U.S. at 590, the party asserting fair use bears the burden of proof, *Am. Geophysical Union v. Texaco Inc.*, 60 F.3d 913, 918 (2nd Cir. 1994).

The statute's wording, derived from a brief observation of Justice Joseph Story in *Folsom v. Marsh*,[14] does not furnish standards for recognition of fair use. Its instruction to consider the

[14] 9 F. Cas. 342, 348 (C.C.D. Mass. 1841) ("[W]e must often, in deciding questions of this sort, look to the nature and objects of the selections made, the quantity and value of the materials used, and the degree in which

"purpose and character" of the secondary use and the "nature" of the copyrighted work does not explain what types of "purpose and character" or "nature" favor a finding of fair use and which do not. In fact, as the Supreme Court observed in *Campbell*, the House Report makes clear that, in passing the statute, Congress had no intention of normatively dictating fair use policy. The purpose of the enactment was to give recognition in the statute itself to such an important part of copyright law developed by the courts through the common law process. "Congress meant § 107 'to restate the present judicial doctrine of fair use, not to change, narrow, or enlarge it an any way,' and intended that courts continue the common-law tradition of fair use adjudication." *Campbell,* 510 U.S. at 577, (quoting H.R. Rep. No. 94-1476, at 66 (1976), S.Rep. No. 94-473, at 62 (1975), U.S. Code Cong. & Admin. News 5659, 5679 (1976)). Furthermore, notwithstanding fair use's long common-law history, not until the *Campbell* ruling in 1994 did courts undertake to explain the standards for finding fair use.

The *Campbell* Court undertook a comprehensive analysis of fair use's requirements, discussing every segment of § 107. Beginning with the examples of purposes set forth in the statute's preamble, the Court made clear that they are "illustrative and not limitative" and "provide only general guidance about the sorts of copying that courts and Congress most commonly ha[ve] found to be fair uses." 510 U.S. at 577-578 (internal quotations and citations omitted). The statute "calls for case-by-case analysis" and "is not to be simplified with bright-line rules." Id. at 577. Section 107's four factors are not to "be treated in isolation, one from another. All are to be explored, and the results weighed together, in light of the purposes of copyright." Id. at 578. Each factor thus stands as part of a multifaceted assessment of the crucial question: how to define the boundary limit of the original author's exclusive rights in order to best serve the overall objectives of the copyright law to expand public learning while protecting the incentives of authors to create for the public good.

At the same time, the Supreme Court has made clear that some of the statute's four listed factors are more significant than others. The Court observed in *Harper & Row Publishers, Inc. v. Nation Enterprises* that the fourth factor, which assesses the harm the secondary use can cause to the market for, or the value of, the copyright for the original, "is undoubtedly the single most important element of fair use." 471 U.S. 539, 566 (1985). This is consistent with the fact that the copyright is a commercial right, intended to protect the ability of authors to profit from the exclusive right to merchandise their own work.

In *Campbell*, the Court stressed also the importance of the first factor, the "purpose and character of the secondary use." 17 U.S.C. § 107(1). The more the appropriator is using the copied material for new, transformative purposes, the more it serves copyright's goal of enriching public knowledge and the less likely it is that the appropriation will serve as a substitute for the original or its plausible derivatives, shrinking the protected market opportunities of the copyrighted work. 510 U.S. at 591 (noting that, when the secondary use is transformative, "market substitution is at least less certain, and market harm may not be so readily inferred.").

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the use may prejudice the sale, or diminish the profits, or supersede the objects, of the original work.").

With this background, we proceed to discuss each of the statutory factors, as illuminated by *Campbell* and subsequent case law, in relation to the issues here in dispute.

II. The Search and Snippet View Functions

A. Factor One

(1) Transformative purpose. *Campbell's* explanation of the first factor's inquiry into the "purpose and character" of the secondary use focuses on whether the new work, "in Justice Story's words, ... merely 'supersede[s] the objects' of the original creation, ... or instead adds something new, with a further purpose.... [I]t asks, in other words, whether and to what extent the new work is 'transformative.'" 510 U.S. at 578-579 (citations omitted). While recognizing that a transformative use is "not absolutely necessary for a finding of fair use," the opinion further explains that the "goal of copyright, to promote science and the arts, is generally furthered by the creation of transformative works" and that "[s]uch works thus lie at the heart of the fair use doctrine's guarantee of breathing space within the confines of copyright." Id. at 579. In other words, transformative uses tend to favor a fair use finding because a transformative use is one that communicates something new and different from the original or expands its utility, thus serving copyright's overall objective of contributing to public knowledge.

The word "transformative" cannot be taken too literally as a sufficient key to understanding the elements of fair use. It is rather a suggestive symbol for a complex thought, and does not mean that any and all changes made to an author's original text will necessarily support a finding of fair use. The Supreme Court's discussion in *Campbell* gave important guidance on assessing when a transformative use tends to support a conclusion of fair use. The defendant in that case defended on the ground that its work was a parody of the original and that parody is a time-honored category of fair use. Explaining why parody makes a stronger, or in any event more obvious, claim of fair use than satire, the Court stated,

> [T]he heart of any parodist's claim to quote from existing material ... is the use of ... a prior author's composition to ... *comment[] on that author's works*.... If, on the contrary, the commentary has no critical bearing on the substance or style of the original composition, which the alleged infringer merely uses to get attention or to avoid the drudgery in working up something fresh, the claim to fairness in borrowing from another's work diminishes accordingly (if it does not vanish).... Parody needs to mimic an original to make its point, and so has some claim to use the creation of its victim's ... imagination, whereas satire can stand on its own two feet and so requires justification for the very act of borrowing.

Id. at 580-81 (emphasis added). In other words, the would-be fair user of another's work must have justification for the taking. A secondary author is not necessarily at liberty to make wholesale takings of the original author's expression merely because of how well the original author's expression would convey the secondary author's different message. Among the best recognized justifications for copying from another's work is to provide comment on it or criticism of it. A taking from another author's work for the purpose of making points that have no bearing on the original may well be fair use, but the taker would need to show a justification. This part of the Supreme Court's discussion is significant in assessing Google's claim of fair use because, as discussed extensively below, Google's claim of transformative purpose for copying from the works of others is to provide otherwise unavailable information about the originals.

A further complication that can result from oversimplified reliance on whether the copying involves transformation is that the word "transform" also plays a role in defining "derivative works," over which the original rights holder retains exclusive control. Section 106 of the Act specifies the "exclusive right[]" of the copyright owner "(2) to prepare derivative works based upon the copyrighted work." See 17 U.S.C. § 106. The statute defines derivative works largely by example, rather than explanation. The examples include "translation, musical arrangement, dramatization, fictionalization, motion picture version, sound recording, art reproduction, abridgement, condensation," to which list the statute adds "any other form in which a work may be ... *transformed*." 17 U.S.C. § 101 (emphasis added).[15] As we noted in *Authors Guild, Inc. v. HathiTrust*, "[p]aradigmatic examples of derivative works include the translation of a novel into another language, the adaptation of a novel into a movie or play, or the recasting of a novel as an e-book or an audiobook." 755 F.3d 87, 95 (2nd Cir. 2014). While such changes can be described as transformations, they do not involve the kind of transformative purpose that favors a fair use finding. The statutory definition suggests that derivative works generally involve transformations in the nature of changes of form. 17 U.S.C. § 101. By contrast, copying from an original for the purpose of criticism or commentary on the original or provision of information about it, tends most clearly to satisfy *Campbell's* notion of the "transformative" purpose involved in the analysis of Factor One.

With these considerations in mind, we first consider whether Google's search and snippet views functions satisfy the first fair use factor with respect to Plaintiffs' rights in their books. (The question whether these functions might infringe upon Plaintiffs' derivative rights is discussed in the next Part.)

(2) Search Function. We have no difficulty concluding that Google's making of a digital copy of Plaintiffs' books for the purpose of enabling a search for identification of books containing a term of interest to the searcher involves a highly transformative purpose, in the sense intended by *Campbell*. Our court's exemplary discussion in *HathiTrust* informs our ruling. That case involved a dispute that is closely related, although not identical, to this one. Authors brought claims of copyright infringement against HathiTrust, an entity formed by libraries participating in the Google Library Project to pool the digital copies of their books created for them by Google. The suit challenged various usages HathiTrust made of the digi-

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[15] The full text of the statutory definition is as follows: "A 'derivative work' is a work based upon one or more preexisting works, such as a translation, musical arrangement, dramatization, fictionalization, motion picture version, sound recording, art reproduction, abridgement, condensation, or any other form in which a work may be recast, transformed, or adapted. A work consisting of editorial revisions, annotations, elaborations, or other modifications which, as a whole, represent an original work of authorship, is a 'derivative work.'" 17 U.S.C. § 101.

tal copies. Among the challenged uses was HathiTrust's offer to its patrons of "full-text searches," which, very much like the search offered by Google Books to Internet users, permitted patrons of the libraries to locate in which of the digitized books specific words or phrases appeared. 755 F.3d at 98. (HathiTrust's search facility did not include the snippet view function, or any other display of text.) We concluded that both the making of the digital copies and the use of those copies to offer the search tool were fair uses. Id. at 105.

Notwithstanding that the libraries had downloaded and stored complete digital copies of entire books, we noted that such copying was essential to permit searchers to identify and locate the books in which words or phrases of interest to them appeared. Id. at 97. We concluded "that the creation of a full-text searchable database is a quintessentially transformative use ... [as] the result of a word search is different in purpose, character, expression, meaning, and message from the page (and the book) from which it is drawn." Id.

As with *HathiTrust* ***, the purpose of Google's copying of the original copyrighted books is to make available significant information about those books, permitting a searcher to identify those that contain a word or term of interest, as well as those that do not include reference to it. In addition, through the ngrams tool, Google allows readers to learn the frequency of usage of selected words in the aggregate corpus of published books in different historical periods. We have no doubt that the purpose of this copying is the sort of transformative purpose described in Campbell as strongly favoring satisfaction of the first factor.

We recognize that our case differs from *HathiTrust* in two potentially significant respects. First, HathiTrust did not "display to the user any text from the underlying copyrighted work," 755 F.3d at 91, whereas Google Books provides the searcher with snippets containing the word that is the subject of the search. Second, HathiTrust was a nonprofit educational entity, while Google is a profit-motivated commercial corporation. We discuss those differences below.

(3) Snippet View. Plaintiffs correctly point out that this case is significantly different from *HathiTrust* in that the Google Books search function allows searchers to read snippets from the book searched, whereas HathiTrust did not allow searchers to view any part of the book. Snippet view adds important value to the basic transformative search function, which tells only whether and how often the searched term appears in the book. Merely knowing that a term of interest appears in a book does not necessarily tell the searcher whether she needs to obtain the book, because it does not reveal whether the term is discussed in a manner or context falling within the scope of the searcher's interest. For example, a searcher seeking books that explore Einstein's theories, who finds that a particular book includes 39 usages of "Einstein," will nonetheless conclude she can skip that book if the snippets reveal that the book speaks of "Einstein" because that is the name of the author's cat. In contrast, the snippet will tell the searcher that this is a book she needs to obtain if the snippet shows that the author is engaging with Einstein's theories.

Google's division of the page into tiny snippets is designed to show the searcher just enough context surrounding the searched term to help her evaluate whether the book falls within the scope of her interest (without revealing so much as to threaten the author's copyright interests). Snippet view thus adds importantly to the highly transformative purpose of identifying books of interest to the searcher. With respect to the first factor test, it favors a finding of fair use (unless the value of its transformative purpose is overcome by its providing text in a manner that offers a competing substitute for Plaintiffs' books, which we discuss under factors three and four below).

(4) Google's Commercial Motivation. Plaintiffs also contend that Google's commercial motivation weighs in their favor under the first factor. Google's commercial motivation distinguishes this case from HathiTrust, as the defendant in that case was a non-profit entity founded by, and acting as the representative of, libraries. Although Google has no revenues flowing directly from its operation of the Google Books functions, Plaintiffs stress that Google is profit-motivated and seeks to use its dominance of book search to fortify its overall dominance of the Internet search market, and that thereby Google indirectly reaps profits from the Google Books functions.

For these arguments Plaintiffs rely primarily on two sources. First is Congress's specification in spelling out the first fair use factor in the text of § 107 that consideration of the "purpose and character of the [secondary] use" should "include[e] whether such use is of a commercial nature or is for nonprofit educational purposes." Second is the Supreme Court's assertion in dictum in *Sony Corporation of America v. Universal City Studios, Inc*, that "every commercial use of copyrighted material is presumptively ... unfair." 464 U.S. 417, 451 (1984). If that were the extent of precedential authority on the relevance of commercial motivation, Plaintiffs' arguments would muster impressive support. However, while the commercial motivation of the secondary use can undoubtedly weigh against a finding of fair use in some circumstances, the Supreme Court, our court, and others have eventually recognized that the *Sony* dictum was enormously overstated. ***

Our court has since repeatedly rejected the contention that commercial motivation should outweigh a convincing transformative purpose and absence of significant substitutive competition with the original. See *Cariou v. Prince*, 714 F.3d 694, 708 (2nd Cir. 2013), ("The commercial/nonprofit dichotomy concerns the unfairness that arises when a secondary user makes unauthorized use of copyrighted material to capture significant revenues as a direct consequence of copying the original work. This factor must be applied with caution because, as the Supreme Court has recognized, Congress could not have intended a rule that commercial uses are presumptively unfair. Instead, the more transformative the new work, the less will be the significance of other factors, like commercialism, that may weigh against a finding of fair use.") (internal quotation marks, citations, and alterations omitted).

While we recognize that in some circumstances, a commercial motivation on the part of the secondary user will weigh against her, especially, as the Supreme Court suggested, when a persuasive transformative purpose is lacking, *Campbell*, 510 U.S. at 579, we see no reason in this case why Google's overall profit motivation should prevail as a reason for denying fair use over its highly convincing transformative purpose, together with the absence of significant substitutive competition, as reasons for granting fair use. Many of the most universally accepted forms of fair use, such as news reporting and commentary, quotation in historical or analytic books, reviews of books, and performances, as well as parody, are all normally done commercially for profit.[20]

B. Factor Two

The second fair use factor directs consideration of the "nature of the copyrighted work." While the "transformative purpose" inquiry discussed above is conventionally treated as a part of first factor analysis, it inevitably involves the second factor as well. One cannot assess whether the copying work has an objective that differs from the original without considering both works, and their respective objectives.

The second factor has rarely played a significant role in the determination of a fair use dispute. The Supreme Court in *Harper & Row* made a passing observation in dictum that, "[t]he law generally recognizes a greater need to disseminate factual works than works of fiction or fantasy." 471 U.S. 539, 563 (1985). Courts have sometimes speculated that this might mean that a finding of fair use is more favored when the copying is of factual works than when copying is from works of fiction. However, while the copyright does not protect facts or ideas set forth in a work, it does protect that author's manner of expressing those facts and ideas. At least unless a persuasive fair use justification is involved, authors of factual works, like authors of fiction, should be entitled to copyright protection of their protected expression. The mere fact that the original is a factual work therefore should not imply that others may freely copy it. Those who report the news undoubtedly create factual works. It cannot seriously be argued that, for that reason, others may freely copy and re-disseminate news reports.

In considering the second factor in *HathiTrust*, we concluded that it was "not dispositive," 755 F.3d at 98, commenting that courts have hardly ever found that the second factor in isolation played a large role in explaining a fair use decision. The same is true here. While each of the three Plaintiffs' books in this case is factual, we do not consider that as a boost to Google's claim of fair use. If one (or all) of the plaintiff works were fiction, we do not think that would change in any way our appraisal. Nothing in this case influences us one way or the other with respect to the second factor considered in isolation. To the extent that the "nature" of the original copyrighted work necessarily combines with the "purpose and character" of the secondary work to permit assessment of whether the secondary work uses the original in a "transformative" manner, as the term is used in *Campbell*, the second factor favors fair use not because Plaintiffs' works are factual, but because the secondary use transformatively provides valuable information about the original, rather than replicating protected expression in a manner that provides a meaningful substitute for the original.

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[20] Just as there is no reason for presuming that a commercial use is not a fair use, which would defeat the most widely accepted and logically justified areas of fair use, there is likewise no reason to presume categorically that a nonprofit educational purpose should qualify as a fair use. Authors who write for educational purposes, and publishers who invest substantial funds to publish educational materials, would lose the ability to earn revenues if users were permitted to copy the materials freely merely because such copying was in the service of a nonprofit educational mission. The publication of educational materials would be substantially curtailed if such publications could be freely copied for non-profit educational purposes.

C. Factor Three

The third statutory factor instructs us to consider "the amount and substantiality of the portion used in relation to the copyrighted work as a whole." The clear implication of the third factor is that a finding of fair use is more likely when small amounts, or less important passages, are copied than when the copying is extensive, or encompasses the most important parts of the original. The obvious reason for this lies in the relationship between the third and the fourth factors. The larger the amount, or the more important the part, of the original that is copied, the greater the likelihood that the secondary work might serve as an effectively competing substitute for the original, and might therefore diminish the original rights holder's sales and profits.

(1) Search Function. The Google Books program has made a digital copy of the entirety of each of Plaintiffs' books. Notwithstanding the reasonable implication of Factor Three that fair use is more likely to be favored by the copying of smaller, rather than larger, portions of the original, courts have rejected any categorical rule that a copying of the entirety cannot be a fair use. Complete unchanged copying has repeatedly been found justified as fair use when the copying was reasonably appropriate to achieve the copier's transformative purpose and was done in such a manner that it did not offer a competing substitute for the original. The Supreme Court said in *Campbell* that "the extent of permissible copying varies with the purpose and character of the use" and characterized the relevant questions as whether "the amount and substantiality of the portion used ... are reasonable in relation to the purpose of the copying," Campbell, 510 U.S. at 586-587, noting that the answer to that question will be affected by "the degree to which the [copying work] may serve as a market substitute for the original or potentially licensed derivatives," id. at 587-588 (finding that, in the case of a parodic song, "how much ... is reasonable will depend, say, on the extent to which the song's overriding purpose and character is to parody the original or, in contrast, the likelihood that the parody may serve as a market substitute for the original").

In *HathiTrust*, our court concluded in its discussion of the third factor that "[b]ecause it was reasonably necessary for the [HathiTrust Digital Library] to make use of the entirety of the works in order to enable the full-text search function, we do not believe the copying was excessive." 755 F.3d at 98. As with *HathiTrust*, not only is the copying of the totality of the original reasonably appropriate to Google's transformative purpose, it is literally necessary to achieve that purpose. If Google copied less than the totality of the originals, its search function could not advise searchers reliably whether their searched term appears in a book (or how many times).

While Google makes an unauthorized digital copy of the entire book, it does not reveal that digital copy to the public. The copy is made to enable the search functions to reveal limited, important information about the books. With respect to the search function, Google satisfies the third factor test, as illuminated by the Supreme Court in *Campbell*.

(2) Snippet View. Google's provision of snippet view makes our third factor inquiry different from that inquiry in *HathiTrust*. What matters in such cases is not so much "the amount and substantiality of the portion used" in making a copy, but rather the amount and sub-

stantiality of what is thereby made accessible to a public for which it may serve as a competing substitute. In *HathiTrust*, notwithstanding the defendant's full-text copying, the search function revealed virtually nothing of the text of the originals to the public. Here, through the snippet view, more is revealed to searchers than in *HathiTrust*.

Without doubt, enabling searchers to see portions of the copied texts could have determinative effect on the fair use analysis. The larger the quantity of the copyrighted text the searcher can see and the more control the searcher can exercise over what part of the text she sees, the greater the likelihood that those revelations could serve her as an effective, free substitute for the purchase of the plaintiff's book. We nonetheless conclude that, at least as presently structured by Google, the snippet view does not reveal matter that offers the marketplace a significantly competing substitute for the copyrighted work.

Google has constructed the snippet feature in a manner that substantially protects against its serving as an effectively competing substitute for Plaintiffs' books. In the Background section of this opinion, we describe a variety of limitations Google imposes on the snippet function. These include the small size of the snippets (normally one eighth of a page), the blacklisting of one snippet per page and of one page in every ten, the fact that no more than three snippets are shown—and no more than one per page—for each term searched, and the fact that the same snippets are shown for a searched term no matter how many times, or from how many different computers, the term is searched. In addition, Google does not provide snippet view for types of books, such as dictionaries and cookbooks, for which viewing a small segment is likely to satisfy the searcher's need. The result of these restrictions is, so far as the record demonstrates, that a searcher cannot succeed, even after long extended effort to multiply what can be revealed, in revealing through a snippet search what could usefully serve as a competing substitute for the original.

The blacklisting, which permanently blocks about 22% of a book's text from snippet view, is by no means the most important of the obstacles Google has designed. While it is true that the blacklisting of 22% leaves 78% of a book theoretically accessible to a searcher, it does not follow that any large part of that 78% is in fact accessible. The other restrictions built into the program work together to ensure that, even after protracted effort over a substantial period of time, only small and randomly scattered portions of a book will be accessible. In an effort to show what large portions of text searchers can read through persistently augmented snippet searches, Plaintiffs' counsel employed researchers over a period of weeks to do multiple word searches on Plaintiffs' books. In no case were they able to access as much as 16% of the text, and the snippets collected were usually not sequential but scattered randomly throughout the book. Because Google's snippets are arbitrarily and uniformly divided by lines of text, and not by complete sentences, paragraphs, or any measure dictated by content, a searcher would have great difficulty constructing a search so as to provide any extensive information about the book's use of that term. As snippet view never reveals more than one snippet per page in response to repeated searches for the same term, it is at least difficult, and often impossible, for a searcher to gain access to more than a single snippet's worth of an extended, continuous discussion of the term.

The fact that Plaintiffs' searchers managed to reveal nearly 16% of the text of Plaintiffs' books overstates the degree to which snippet view can provide a meaningful substitute. At least as important as the percentage of words of a book that are revealed is the manner and order in which they are revealed. Even if the search function revealed 100% of the words of the copyrighted book, this would be of little substitutive value if the words were revealed in alphabetical order, or any order other than the order they follow in the original book. It cannot be said that a revelation is "substantial" in the sense intended by the statute's third factor if the revelation is in a form that communicates little of the sense of the original. The fragmentary and scattered nature of the snippets revealed, even after a determined, assiduous, time-consuming search, results in a revelation that is not "substantial," even if it includes an aggregate 16% of the text of the book. If snippet view could be used to reveal a coherent block amounting to 16% of a book, that would raise a very different question beyond the scope of our inquiry.

D. Factor Four

The fourth fair use factor, "the effect of the [copying] use upon the potential market for or value of the copyrighted work," focuses on whether the copy brings to the marketplace a competing substitute for the original, or its derivative, so as to deprive the rights holder of significant revenues because of the likelihood that potential purchasers may opt to acquire the copy in preference to the original. Because copyright is a commercial doctrine whose objective is to stimulate creativity among potential authors by enabling them to earn money from their creations, the fourth factor is of great importance in making a fair use assessment.See *Harper & Row*, 471 U.S. at 566 (describing the fourth factor as "undoubtedly the single most important element of fair use").

Campbell stressed the close linkage between the first and fourth factors, in that the more the copying is done to achieve a purpose that differs from the purpose of the original, the less likely it is that the copy will serve as a satisfactory substitute for the original. 510 U.S. at 591. Consistent with that observation, the *HathiTrust* court found that the fourth factor favored the defendant and supported a finding of fair use because the ability to search the text of the book to determine whether it includes selected words "does not serve as a substitute for the books that are being searched." 755 F.3d at 100.

However, *Campbell*'s observation as to the likelihood of a secondary use serving as an effective substitute goes only so far. Even if the purpose of the copying is for a valuably transformative purpose, such copying might nonetheless harm the value of the copyrighted original if done in a manner that results in widespread revelation of sufficiently significant portions of the original as to make available a significantly competing substitute. The question for us is whether snippet view, notwithstanding its transformative purpose, does that. We conclude that, at least as snippet view is presently constructed, it does not.

Especially in view of the fact that the normal purchase price of a book is relatively low in relation to the cost of manpower needed to secure an arbitrary assortment of randomly scattered snippets, we conclude that the snippet function does not give searchers access to effectively competing substitutes. Snippet view, at best and after a large commitment of manpower, produces discontinuous, tiny fragments, amounting in the aggregate to no more than 16% of a book. This does not threaten the rights holders with any significant harm to the value of their copyrights or diminish their harvest of copyright revenue.

We recognize that the snippet function can cause some loss of sales. There are surely instances in which a searcher's need for access to a text will be satisfied by the snippet view, resulting in either the loss of a sale to that searcher, or reduction of demand on libraries for that title, which might have resulted in libraries purchasing additional copies. But the possibility, or even the probability or certainty, of some loss of sales does not suffice to make the copy an effectively competing substitute that would tilt the weighty fourth factor in favor of the rights holder in the original. There must be a meaningful or significant effect "upon the potential market for or value of the copyrighted work." 17 U.S.C. § 107(4).

Furthermore, the type of loss of sale envisioned above will generally occur in relation to interests that are not protected by the copyright. A snippet's capacity to satisfy a searcher's need for access to a copyrighted book will at times be because the snippet conveys a historical fact that the searcher needs to ascertain. For example, a student writing a paper on Franklin D. Roosevelt might need to learn the year Roosevelt was stricken with polio. By entering "Roosevelt polio" in a Google Books search, the student would be taken to (among numerous sites) a snippet from page 31 of Richard Thayer Goldberg's *The Making of Franklin D. Roosevelt* (1981), telling that the polio attack occurred in 1921. This would satisfy the searcher's need for the book, eliminating any need to purchase it or acquire it from a library. But what the searcher derived from the snippet was a historical fact. Author Goldberg's copyright does not extend to the facts communicated by his book. It protects only the author's manner of expression. Google would be entitled, without infringement of Goldberg's copyright, to answer the student's query about the year Roosevelt was afflicted, taking the information from Goldberg's book. The fact that, in the case of the student's snippet search, the information came embedded in three lines of Goldberg's writing, which were superfluous to the searcher's needs, would not change the taking of an unprotected fact into a copyright infringement.

Even if the snippet reveals some authorial expression, because of the brevity of a single snippet and the cumbersome, disjointed, and incomplete nature of the aggregation of snippets made available through snippet view, we think it would be a rare case in which the searcher's interest in the protected aspect of the author's work would be satisfied by what is available from snippet view, and rarer still—because of the cumbersome, disjointed, and incomplete nature of the aggregation of snippets made available through snippet view—that snippet view could provide a significant substitute for the purchase of the author's book.

Accordingly, considering the four fair use factors in light of the goals of copyright, we conclude that Google's making of a complete digital copy of Plaintiffs' works for the purpose of providing the public with its search and snippet view functions (at least as snippet view is presently designed) is a fair use and does not infringe Plaintiffs' copyrights in their books.

III. Derivative Rights in Search and Snippet View

Plaintiffs next contend that, under Section 106(2), they have a derivative right in the application of search and snippet view functions to their works, and that Google has usurped their exclusive market for such derivatives.

There is no merit to this argument. As explained above, Google does not infringe Plaintiffs' copyright in their works by making digital copies of them, where the copies are used to enable the public to get information about the works, such as whether, and how often they use specified words or terms (together with peripheral snippets of text, sufficient to show the context in which the word is used but too small to provide a meaningful substitute for the work's copyrighted expression). The copyright resulting from the Plaintiffs' authorship of their works does not include an exclusive right to furnish the kind of information about the works that Google's programs provide to the public. For substantially the same reasons, the copyright that protects Plaintiffs' works does not include an exclusive derivative right to supply such information through query of a digitized copy.

The extension of copyright protection beyond the copying of the work in its original form to cover also the copying of a derivative reflects a clear and logical policy choice. An author's right to control and profit from the dissemination of her work ought not to be evaded by conversion of the work into a different form. The author of a book written in English should be entitled to control also the dissemination of the same book translated into other languages, or a conversion of the book into a film. The copyright of a composer of a symphony or song should cover also conversions of the piece into scores for different instrumentation, as well as into recordings of performances.

This policy is reflected in the statutory definition, which explains the scope of the "derivative" largely by examples—including "a translation, musical arrangement, dramatization, fictionalization, motion picture version, sound recording, art reproduction, abridgement, [or] condensation"—before adding, "or any other form in which a work may be recast, transformed, or adapted." 17 U.S.C. § 101. As noted above, this definition, while imprecise, strongly implies that derivative works over which the author of the original enjoys exclusive rights ordinarily are those that re-present the protected aspects of the original work, i.e., its expressive content, converted into an altered form, such as the conversion of a novel into a film, the translation of a writing into a different language, the reproduction of a painting in the form of a poster or post card, recreation of a cartoon character in the form of a three-dimensional plush toy, adaptation of a musical composition for different instruments, or other similar conversions. If Plaintiffs' claim were based on Google's converting their books into a digitized form and making that digitized version accessible to the public, their claim would be strong. But as noted above, Google safeguards from public view the digitized copies it makes and allows access only to the extent of permitting the public to search for the very limited information accessible through the search function and snippet view. The program does not allow access in any substantial way to a book's expressive content. Nothing in the statutory definition of a derivative work, or of the logic that underlies it, suggests that the author of an original work enjoys an exclusive derivative right to supply information about that work of the sort communicated by Google's search functions.

Plaintiffs seek to support their derivative claim by a showing that there exist, or would have existed, paid licensing markets in digitized works, such as those provided by the Copyright Clearance Center or the previous, revenue-generating version of the Google Partners Program. Plaintiffs also point to the proposed settlement agreement rejected by the district court in this case, according to which Google would have paid authors for its use of digitized copies of their works. The existence or potential existence of such paid licensing schemes does not support Plaintiffs' derivative argument. The access to the expressive content of the original that is or would have been provided by the paid licensing arrangements Plaintiffs cite is far more extensive than that which Google's search and snippet view functions provide. Those arrangements allow or would have allowed public users to read substantial portions of the book. Such access would most likely constitute copyright infringement if not licensed by the rights holders. Accordingly, such arrangements have no bearing on Google's present programs, which, in a non-infringing manner, allow the public to obtain limited data about the contents of the book, without allowing any substantial reading of its text.

Plaintiffs also seek to support their derivative claim by a showing that there is a current unpaid market in licenses for partial viewing of digitized books, such as the licenses that publishers currently grant to the Google Partners program and Amazon's Search Inside the Book program to display substantial portions of their books. Plaintiffs rely on *Infitinity Broadcast Corporation v. Kirkwood*, 150 F.3d 104 (2nd Cir. 1998) and *United States v. American Society of Composers, Authors and Publishers (ASCAP)*, 599 F.Supp.2d 415 (S.D.N.Y. 2009) for the proposition that "a secondary use that replaces a comparable service licensed by the copyright holder, even without charge, may cause market harm." Pls.' Br. at 51. In the cases cited, however, the purpose of the challenged secondary uses was not the dissemination of information about the original works, which falls outside the protection of the copyright, but was rather the re-transmission, or re-dissemination, of their expressive content. Those precedents do not support the proposition Plaintiffs assert—namely that the availability of licenses for providing unprotected information about a copyrighted work, or supplying unprotected services related to it, gives the copyright holder the right to exclude others from providing such information or services.

While the telephone ringtones at issue in the *ASCAP* case Plaintiffs cite are superficially comparable to Google's snippets in that both consist of brief segments of the copyrighted work, in a more significant way they are fundamentally different. While it is true that Google's snippets display a fragment of expressive content, the fragments it displays result from the appearance of the term selected by the searcher in an otherwise arbitrarily selected snippet of text. Unlike the reading experience that the Google Partners program or the Amazon Search Inside the Book program provides, the snippet function does not provide searchers with any meaningful experience of the expressive content of the book. Its purpose is not to communicate copyrighted expression, but rather, by revealing to the searcher a tiny segment surrounding the searched term, to give some minimal contextual information to help the searcher learn whether the book's use of that term will be of interest to her. The segments taken from copyrighted music as ringtones, in contrast, are selected precisely because they play the most famous, beloved passages of the particular piece—the expressive content that members of the public want to hear when their phone rings. The value of the ringtone to the purchaser is not that it provides information but that it provides a mini-performance of the most appealing segment of the author's expressive content. There is no reason to think the courts in the cited cases would have come to the same conclusion if the service being provided by the secondary user had been simply to identify to a subscriber in what key a selected composition was written, the year it was written, or the name of the composer. These cases, and the existence of unpaid licensing schemes for substantial viewing of digitized works, do not support Plaintiffs' derivative works argument.

IV. Plaintiffs' Exposure to Risks of Hacking of Google's Files

Plaintiffs argue that Google's storage of its digitized copies of Plaintiffs' books exposes them to the risk that hackers might gain access and make the books widely available, thus destroying the value of their copyrights. Unlike the Plaintiffs' argument just considered based on a supposed derivative right to supply information about their books, this claim has a reasonable theoretical basis. If, in the course of making an arguable fair use of a copyrighted work, a secondary user unreasonably exposed the rights holder to destruction of the value of the copyright resulting from the public's opportunity to employ the secondary use as a substitute for purchase of the original (even though this was not the intent of the secondary user), this might well furnish a substantial rebuttal to the secondary user's claim of fair use. For this reason, the *Arriba Soft* and *Perfect 10* courts, in upholding the secondary user's claim of fair use, observed that thumbnail images, which transformatively provided an Internet pathway to the original images, were of sufficiently low resolution that they were not usable as effective substitutes for the originals. *Arriba Soft*, 336 F.3d 811 at 819; *Perfect 10*, 508 F.3d at 1165.

While Plaintiffs' claim is theoretically sound, it is not supported by the evidence. In *HathiTrust*, we faced substantially the same exposure-to-piracy argument. The record in *HathiTrust*, however, "document[ed] the extensive security measures [the secondary user] ha[d] undertaken to safeguard against the risk of a data breach," evidence which was unrebutted. 755 F.3d at 100. The *HathiTrust* court thus found "no basis ... on which to conclude that a security breach is likely to occur, much less one that would result in the public release of the specific copyrighted works belonging to any of the plaintiffs in this case." Id. at 100-101 (citing *Clapper v. Amnesty Int'l USA,* 133 S.Ct. 1138, 1143 (2013) (finding that risk of future harm must be "certainly impending," rather than merely "conjectural" or "hypothetical," to constitute a cognizable injury-in-fact), and *Sony Corp.*, 464 U.S. at 453-454 (concluding that time-shifting using a Betamax is fair use because the copyright owners' "prediction that live television or movie audiences will decrease" was merely "speculative")).

Google has documented that Google Books' digital scans are stored on computers walled off from public Internet access and protected by the same impressive security measures used by Google to guard its own confidential information. As Google notes, Plaintiffs' own security expert praised these security systems, remarking that "Google is fortunate to have ample resources and top-notch technical talents" that enable it to protect its data. JA 1558, 1570.

Nor have Plaintiffs identified any thefts from Google Books (or from the Google Library Project). Plaintiffs seek to rebut this record by quoting from Google's July 2012 SEC filing, in which the company made legally required disclosure of its potential market risks.[26] Google's prudent acknowledgment that "security breaches could expose [it] to a risk of loss... due to the actions of outside parties, employee error, malfeasance, or otherwise," however, falls far short of rebutting Google's demonstration of the effective measures it takes to guard against piratical hacking. Google has made a sufficient showing of protection of its digitized copies of Plaintiffs' works to carry its burden on this aspect of its claim of fair use and thus to shift to Plaintiffs the burden of rebutting Google's showing. Plaintiffs' effort to do so falls far short.

V. Google's Distribution of Digital Copies to Participant Libraries

Finally, Plaintiffs contend that Google's distribution to a participating library of a digital copy of Plaintiffs' books is not a fair use and exposes the Plaintiffs to risks of loss if the library uses its digital copy in an infringing manner, or if the library fails to maintain security over its digital copy with the consequence that the book may become freely available as a result of the incursions of hackers. The claim fails.

Although Plaintiffs describe the arrangement between Google and the libraries in more nefarious terms, those arrangements are essentially that each participant library has contracted with Google that Google will create for it a digital copy of each book the library submits to Google, so as to permit the library to use its digital copy in a non-infringing fair use manner. The libraries propose to use their digital copies to enable the very kinds of searches that we here hold to be fair uses in connection with Google's offer of such searches to the Internet public, and which we held in *HathiTrust* to be fair uses when offered by HathiTrust to its users. The contract between Google and each of the participating libraries commits the library to use its digital copy only in a manner consistent with the copyright law, and to take precautions to prevent dissemination of their digital copies to the public at large.

In these circumstances, Google's creation for each library of a digital copy of that library's already owned book in order to permit that library to make fair use through provision of dig-

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[26] The filing includes the following disclosure:

Our products and services involve the storage and transmission of users' and customers' proprietary information, and security breaches could expose us to a risk of loss of this information, litigation, and potential liability. Our security measures may be breached due to the actions of outside parties, employee error, malfeasance, or otherwise, and, as a result, an unauthorized party may obtain access to our data or our users' or customers' data. Additionally, outside parties may attempt to fraudulently induce employees, users, or customers to disclose sensitive information in order to gain access to our data or our users' or customers' data. Any such breach or unauthorized access could result in significant legal and financial exposure, damage to our reputation, and a loss of confidence in the security of our products and services that could potentially have an adverse effect on our business. Because the techniques used to obtain unauthorized access, disable or degrade service, or sabotage systems change frequently and often are not recognized until launched against a target, we may be unable to anticipate these techniques or to implement adequate preventative measures. If an actual or perceived breach of our security occurs, the market perception of the effectiveness of our security measures could be harmed and we could lose users and customers.

ital searches is not an infringement. If the library had created its own digital copy to enable its provision of fair use digital searches, the making of the digital copy would not have been infringement. Nor does it become an infringement because, instead of making its own digital copy, the library contracted with Google that Google would use its expertise and resources to make the digital conversion for the library's benefit.

We recognize the possibility that libraries may use the digital copies Google created for them in an infringing manner. If they do, such libraries may be liable to Plaintiffs for their infringement. It is also possible that, in such a suit, Plaintiffs might adduce evidence that Google was aware of or encouraged such infringing practices, in which case Google could be liable as a contributory infringer. But on the present record, the possibility that libraries may misuse their digital copies is sheer speculation. Nor is there any basis on the present record to hold Google liable as a contributory infringer based on the mere speculative possibility that libraries, in addition to, or instead of, using their digital copies of Plaintiffs' books in a non-infringing manner, may use them in an infringing manner.

We recognize the additional possibility that the libraries might incur liability by negligent mishandling of, and failure to protect, their digital copies, leaving them unreasonably vulnerable to hacking. That also, however, is nothing more than a speculative possibility. There is no basis in the record to impose liability on Google for having lawfully made a digital copy for a participating library so as to enable that library to make non-infringing use of its copy, merely because of the speculative possibility that the library may fail to guard sufficiently against the dangers of hacking, as it is contractually obligated to do. Plaintiffs have failed to establish any basis for holding Google liable for its creation of a digital copy of a book submitted to it by a participating library so as to enable that library to make fair use of it.

In sum, we conclude that: (1) Google's unauthorized digitizing of copyright-protected works, creation of a search functionality, and display of snippets from those works are non-infringing fair uses. The purpose of the copying is highly transformative, the public display of text is limited, and the revelations do not provide a significant market substitute for the protected aspects of the originals. Google's commercial nature and profit motivation do not justify denial of fair use. (2) Google's provision of digitized copies to the libraries that supplied the books, on the understanding that the libraries will use the copies in a manner consistent with the copyright law, also does not constitute infringement. Nor, on this record, is Google a contributory infringer. ***

LOT AGREEMENT

THIS LOT AGREEMENT ("Agreement") is entered into upon the undersigned LOT User's submission of a signed copy of the completed Agreement to the LOT Administrator, and is effective as to that LOT User upon the date of such submission (the "Effective Date"), whereby such LOT User becomes a party to this Agreement on behalf of itself and its Affiliates and becomes bound by the terms and conditions. This Agreement is by and between the undersigned LOT User and all other current and future LOT Users.

NOW THEREFORE, each LOT User agrees as follows.

1. License Grant and Release

1.1. Grant of License and Release. With respect to each of its Subject Patents, and subject to the conditions and limitations of this Agreement, each Licensor hereby grants to every Licensee a present, fully vested and irrevocable (except as provided in Section 2 below):

(a) worldwide, royalty-free, non-exclusive, non-sublicensable, non-transferable (subject to the provisions of Section 2 below) license to make, have made, operate, have operated, use, sell, offer for sale, import, and otherwise distribute Products and Services at any time on or after any Transfer of the respective Subject Patent to an Assertion Entity; and

(b) release, effective immediately prior to first Transfer of the respective Subject Patent to an Assertion Entity, of any and all claims, liabilities and damages for all Infringement of the respective Subject Patent occurring prior to the date of such Transfer of the respective Subject Patent.

1.2. Waiver and Immunity. With respect to each Subject Patent of the Licensor, the License constitutes a present, fully vested and irrevocable (except as provided in Section 2 below) waiver of the right under the respective Subject Patent for any Assertion Entity to make any Patent Assertion of the respective Subject Patent against any Licensee or with respect to any Licensee's Products and Services. The License further includes immunity following first Transfer of the respective Subject Patent to an Assertion Entity for use, reproduction, and further sale, offer for sale, and distribution of the Licensee's Products and Services by a distributor, reseller, re-licensor or customer of the Licensee, including reproduction and distribution of authorized copies of software sold or otherwise distributed (including by license of copies) by such Licensee.

1.3. No Other Rights. Except as expressly set forth in Sections 1 and 2 no license or right under any Patents is granted by this Agreement, whether by implication, estoppel, or otherwise. For the avoidance of doubt, the Licenses do not release any claims, liabilities or damages for Infringement or otherwise restrict or limit any Patent Assertion of a Subject Patent that has not been Transferred to an Assertion Entity, including against any Licensee or with respect to any Licensee's Products and Services.

1.4. Return of Financial Benefit. Each LOT User agrees that any payment due to or received by such LOT User or its Affiliates (a "Receiving LOT User"), after becoming a LOT User or its Affiliate, resulting from any Patent Assertion by an Assertion Entity against an entity that at the time of the Patent Assertion is a LOT User or its Affiliate (a "Paying LOT User"), to the extent that such Patent Assertion is based on any of the Receiving LOT User's Patents that were Transferred by the Receiving LOT User to an Assertion Entity less than two (2) years prior to the Receiving LOT User becoming a LOT User or its Affiliate (and where the payment due or received is not the result of an agreement between the Receiving LOT User and the Paying LOT User), will be immediately cancelled or returned to the Paying LOT User against whom such Patent Assertion is made.

1.5. Full Force and Effect. All Licenses granted in this Agreement are intended to and shall run with the Subject Patents to which they pertain for the full duration of such Subject Patents and be binding on subsequent owners and licensees. Any transfer or grant of rights in or to a Licensor's Subject Patent(s), whether by such Licensor or any subsequent transferee, shall be subject to the Licenses and continuing obligations of this Agreement with respect to such Subject Patent(s).

2. Assignment, Change of Control, Withdrawal and Amendment

2.1. Assignment. Subject to the provisions of Section 2.2 below and except as set forth in the next sentence, no LOT User, Licensor or Licensee or their respective Affiliates may assign this Agreement or its rights hereunder, including but not limited to by operation of law, and any attempt to do so shall be void. A LOT User may assign this Agreement to its Affiliate solely as necessary to effect a corporate reorganization of such LOT User that does not constitute a Change of Control.

2.2. Change of Control.

(a) LOT User. In the event that a LOT User undergoes a Change of Control, whether during or after its Participation Period, by an acquirer that is not and does not become a LOT User or an Affiliate of a LOT User within its Participation Period during the six (6) month period after the effective date of such Change of Control, then the LOT User and all of its Affiliates will be deemed to have withdrawn from this Agreement, effective six (6) months after the effective date of such Change of Control. Notwithstanding Section 6.1, an acquirer and its Affiliates prior to the Change of Control will not be considered to become an Affiliate of the LOT User under this Agreement merely by virtue of having acquired Control of the LOT User.

(b) Affiliate of a LOT User. If an Entity ceases to be an Affiliate of a LOT User and does not become a LOT User prior to the time it ceases to be an Affiliate, then such Entity will be deemed to have withdrawn from this Agreement, effective as of the date it ceases to be an Affiliate of the respective LOT User.

(c) Notice. In order to allow the LOT Administrator to determine a withdrawal date under this Section 2.2, the LOT User agrees to inform the LOT Administrator within thirty (30) days of a Change of Control of the LOT User of the fact of such Change of Control and its respective effective date.

2.3. Withdrawal. A LOT User may withdraw from this Agreement by sending the LOT Administrator a written announcement that declares the LOT User's intent to withdraw and is signed and submitted by an authorized representative of the LOT User. The existence and date of each such announcement will be published on the LOT website. The LOT User's withdrawal will be effective as to such LOT User and all of its Affiliates six (6) months after it sends the withdrawal announcement.

2.4. Scope of Rights Following Effective Date of Withdrawal.

(a) Inbound Licenses. The Licenses granted to a LOT User or its Affiliate that has or is deemed to have withdrawn will remain in effect only with respect to Subject Patents of Licensors that were Transferred to an Assertion Entity prior to the date on which such withdrawal is effective.

(b) Outbound Licenses. All Patents of a LOT User or its Affiliate that are Subject Patents as of the date on which withdrawal or deemed withdrawal is effective as to such Entity shall remain Subject Patents and will remain and continue to be licensed following withdrawal to all Licensees existing as of the date of withdrawal and to all Licensees that become an Affiliate of an existing Licensee after the date of withdrawal, subject to the terms and conditions of this Agreement, including Subject Patents Transferred to an Assertion Entity after the date on which withdrawal is effective.

2.5. Amendment. Provisions regarding amendment of this Agreement are set forth in Exhibit B, incorporated into this Agreement as if fully set forth herein.

3. Warranties

3.1. Disclaimer. EACH LICENSOR OFFERS THE PATENT LICENSES GRANTED HEREIN "AS IS" AND MAKES NO REPRESENTATIONS OR WARRANTIES OF ANY KIND CONCERNING ITS PATENTS.

3.2. Representations and Warranties. Notwithstanding Section 3.1, each LOT User represents and warrants that:

(a) it is duly organized, validly existing and in good standing under the laws of its jurisdiction of organization and that it has the full right and power to grant the licenses, waivers, immunities, covenants and releases set forth herein;

(b) this Agreement has been duly authorized, executed and delivered by such LOT User and is enforceable against such LOT User;

(c) it has and covenants that it will continue to have and exercise the rights necessary to cause its Affiliates to be bound by the obligations of this LOT Agreement (including the obligation to grant the Licenses with respect to the Subject Patents in accordance herewith); and

(d) it will not use or cooperate with any Financial Investors, Holding Companies, or non-Participating Business Groups for the primary purpose of circumventing its obligations under this Agreement.

4. Disclaimer of Liability

IN NO EVENT SHALL ANY LOT USER OR ANY OF ITS AFFILIATES BE LIABLE UNDER THIS AGREEMENT, OR BY VIRTUE OF GRANTING ANY LICENSES HEREUNDER, FOR ANY INDIRECT, INCIDENTAL, OR CONSEQUENTIAL DAMAGES, INCLUDING LOST PROFITS, OR FOR ANY OTHER PUNITIVE OR SPECIAL DAMAGES, WHETHER UNDER A THEORY OF WARRANTY, CONTRACT, NEGLIGENCE, OR OTHERWISE, EVEN IF SUCH LOT USER OR ANY OF ITS AFFILIATES HAS BEEN ADVISED OF THE POSSIBILITY OF SUCH DAMAGES PRIOR TO SUCH AN OCCURRENCE.

5. Miscellaneous

5.1. Relationship of the Parties. This Agreement does not create any relationship of agency, partnership or joint venture among the LOT Users or their Affiliates.

5.2. No Impact on Reasonable Royalty or Equitable Relief. Each LOT User and its Affiliates agree that this Agreement does not reflect a royalty that any LOT User or its Affiliate might otherwise have negotiated with respect to any Subject Patents. Each LOT User and its Affiliates further agrees that this Agreement is not intended to, and they will not argue that this Agreement is, relevant to whether an injunction is available or what would constitute a reasonable royalty or a measure of damages for Infringement of any Subject Patents in any dispute outside the scope of this Agreement.

5.3. Third Party Beneficiaries. Each LOT User and each of its Affiliates is an intended third party beneficiary of this Agreement. Except as expressly provided herein, nothing in this Agreement is intended or shall be construed to give any Entity, other than LOT Users and their Affiliates, any legal or equitable right, remedy or claim under or in respect of this Agreement or any provision contained herein.

5.4. Entire Agreement. This Agreement constitutes the entire agreement and understanding of the LOT Users and their Affiliates with respect to the subject matter hereof.

5.5. Bankruptcy. Each LOT User acknowledges and agrees that from and after the Effective Date, and notwithstanding any limitations or conditions in Section 1 or 2 that may apply, (i) this Agreement is an executory contract as that term is used in Section 365 of the United States Bankruptcy Code; (ii) the License granted by each Licensor to each Licensee under this Agreement is subject to Section 365(n) of the Bankruptcy Code; (iii) for the purposes of Section 365(n) of the Bankruptcy Code, the Subject Patents constitute "intellectual property" within the scope of Section 101 of the Bankruptcy Code; and (iv) in the event that any bankruptcy is filed by or against a Licensor, or the Licensor is adjudged bankrupt or insolvent, and the trustee in such bankruptcy rejects this Agreement, each Licensee will have the right to exercise all rights provided by Section 365(n), including but not limited to the right to retain its license rights under this Agreement and any agreement supplementary to this Agreement.

5.6. Costs. LOT Users will pay fees for ongoing costs and operation of LOT Network Inc. and the LOT Administrator in accordance with Exhibit A.

5.7. General Release Waiver. With respect to the releases granted by it in this LOT Agreement, each Licensor voluntarily and with full knowledge of its significance, expressly waives and relinquishes any and all rights they may have under any state or federal statute, rule or common law principle, in law or equity, relating to limitations on releases. SPECIFICALLY, EACH PARTY HEREBY EXPRESSLY WAIVES ANY RIGHTS IT MAY HAVE UNDER CALIFORNIA CIVIL CODE SECTION 1542 WHICH PROVIDES THAT: "A GENERAL RELEASE DOES NOT EXTEND TO CLAIMS WHICH THE CREDITOR DOES NOT KNOW OR SUSPECT TO EXIST IN HIS OR HER FAVOR AT THE TIME OF EXECUTING THE RELEASE, WHICH IF KNOWN BY HIM OR HER MUST HAVE MATERIALLY AFFECTED HIS OR HER SETTLEMENT WITH THE DEBTOR."

5.8. Release for LOT Administrator and LOT Network Inc. Each LOT User releases the LOT Administrator, LOT Network Inc. and their directors, representatives and successors from, and covenants not to bring, any claim or action with respect to, any liability associated with their administration of this Agreement.

5.9. Notice. All notices and communications pursuant to this Agreement shall be in writing and signed by the Entity giving such notice and shall be deemed to have been given upon receipt or upon tender by electronic mail with a follow-on hardcopy using a priority or express courier, postage prepaid to the noticed party as follows: (a) in the case of the undersigned LOT User, to the email and mailing addresses provided on the signature page hereto, which addresses may be updated by notice from such LOT User to the LOT Administrator; and (b) in the case of the LOT Administrator, to the email and mailing addresses for the LOT Administrator as of the date of notice as specified on the LOT website.

5.10. Section Headings. The Section headings contained in this Agreement are for reference purposes only and shall not in any way control the meaning or interpretation of this Agreement.

5.11. Governing Law. This Agreement will be interpreted, construed, and enforced in all respects in accordance with the laws of the State of New York, without reference to its choice of law principles.

6. Definitions

6.1. "Affiliate" means, with respect to a first Entity, any Entity that directly or indirectly Controls, is Controlled by, or is under common Control with such first Entity, but only for so long as such Control exists; provided, however, that:

(a) in the event that a LOT User is or becomes Controlled by a Financial Investor, then such Financial Investor (and any Entities that (i) are Controlled by such Financial Investor, (ii) are not Affiliates of such LOT User other than because of their common Control by such Financial Investor, and (iii) do not exist for the primary purpose of attempting to avoid having Patents be subject to this Agreement) will not be considered Affiliates of such LOT User for so long as such Financial Investor remains a non-Assertion Entity; and

(b) in the event that a LOT User is or becomes Controlled by an Entity ("Holding Company") that Controls a group of Entities that conduct substantially separate and identifiable businesses (each such Entity and its Controlled Affiliates, a "Business Group"), then such Holding Company (and any Entities that (i) are Controlled by such Holding Company, (ii) are not Affiliates of such LOT User other than because of their common Control by such Holding Company, and (iii) do not exist for the primary purpose of attempting to avoid having Patents be subject to this Agreement) will not be considered Affiliates of such LOT User for so long as such Holding Company remains a non-Assertion Entity, provided that one or more of the Business Groups that becomes a LOT User together with its Controlled Affiliates ("Participating Business Groups") (x) owns or controls at least 10,000 active U.S. Subject Patents at the time of becoming a LOT User, and (y) has aggregate consolidated revenues, exclusive of revenue derived from Patent Assertions, measured over the full twelve (12) months preceding the date it becomes a LOT User of greater than $1 billion. Any such LOT User will confirm whether it is subject to this Section 6.1(b) upon written request from another LOT User.

6.2. "Assertion Entity" means an Entity and each one of its Affiliates if such Entity and all its Affiliates collectively derived from Patent Assertion more than half of their total consolidated gross revenue measured over the full twelve (12) months preceding a particular date (other than as a result, during such twelve (12) month period, of a damages award or settlement obtained in such period from patent infringement proceedings brought by such Entity or its Affiliates against one or more other Entities based on such other Entities' sale or distribution of one or more infringing products or services that compete against one or more bona fide commercial products or services of such Entity or its Affiliates, *provided* that such Entity and all its Affiliates collectively did not derive (or were not awarded or did not otherwise obtain the right to deriv*e pursua*nt to a settlement) from Patent Assertion an amount equaling more than half of their total consolidated gross revenue measured over the full twenty-four (24) months preceding the particular date). Without limiting the foregoing, the following will be counted as revenue derived by an Entity from Patent Assertion for purposes of this definition (i) royalties and other monetary compensation arising from grant of releases, licenses, covenants not to sue or other rights to Patent(s) for the primary purpose of deriving royalties or other monetary compensation under such Patent(s), where such rights are not granted in connection with Products and Services provided by such Entity or its Affiliates relating to such Patent(s) (which shall be counted as revenue at the time of receipt), (ii) monetary compensation arising from settlement of Patent Assertion (which shall be counted as revenue at the time of receipt), (iii) damages awarded arising from a Patent Assertion (which shall be counted as revenue at the time of award, even if not collected), and (iv) imputed revenue of $100,000 for each Infringement complaint filed for a Patent Assertion (which shall be counted as revenue at the time of filing). In addition, an Entity and each of its Affiliates will be deemed to be an Assertion Entity if the Entity or any of its Affiliate has, as of a particular date, a goal or plan approved by senior management or a senior executive (or under which the Entity has begun to receive revenue) to derive from Patent Assertion, either directly, or indirectly through one or more of its Affiliates, more than half of the total consolidated gross revenue of such Entity and its Affiliates collectively in any twelve (12) month period including or after that particular date.

6.3. "Change of Control" means, with respect to a first Entity:

(a) direct or indirect acquisition (except for transactions described in clause (b) below), whether in one or a series of transactions, by a second Entity or related Entities of Control of the first Entity; or

(b) a merger, consolidation or other reorganization or recapitalization of the first Entity with a second Entity or a direct or indirect subsidiary of such second Entity, *provided* that a result of the consummation of such merger, consolidation or other reorganization or recapitalization, whether in one or a series of related transactions, is that the holders of Control of the first Entity immediately prior to such consummation do not Control, immediately after the consummation, the Entity surviving such merger, consolidation or other reorganization or recapitalization, or its direct or indirect parent Entity.

The "effective date" of a Change of Control is the date on which the relevant acquisition, merger, consolidation, reorganization or recapitalization (as applicable) occurs under applicable law.

6.4. "Control" means (i) the ownership, or the direct or indirect control, of more than fifty percent (50%) of the voting stock or other voting ownership interest of an Entity, or (ii) the sole power to elect, appoint, or cause the election or appointment of, directly or indirectly, at least a majority of the members of the board of directors (or such other governing body that exercises a similar level of control) of an Entity. The terms "Controlled" and "Controls" shall have a correlative meaning.

6.5. "Entity" means an individual, corporation, trust, partnership, joint venture, limited liability company, association, unincorporated organization, or other legal or governmental entity.

6.6. "Financial Investor" means an Entity that is not an Assertion Entity and its primary business is investing in equity securities or debt of non-Assertion Entities (examples of a Financial Investor are a venture capital firm or a private equity firm).

6.7. "Infringement" means direct or indirect infringement of a Patent.

6.8. "License" means the license rights, releases, waivers and immunities granted in Sections 1 and 2 of this Agreement, subject to the terms, conditions and limitations herein.

6.9. "Licensee" means, with respect to each Subject Patent of a Licensor: (i) each LOT User who is within its Participation Period at any time that the respective Licensor or any assignee, transferee or successor has, or after which the Licensor or any assignee, transferee or successor later obtains, the right to grant licenses, releases, waivers or immunities with respect to such Subject Patent of or within the scope granted in the License; and (ii) each Affiliate of such LOT User that is or becomes an Affiliate of the LOT User at any time during such LOT User's Participation Period, subject to Sections 2 as applicable.

6.10. "Licensor" means a LOT User and each Entity that is, was, or becomes, an Affiliate of such LOT User during the LOT User's Participation Period. For avoidance of doubt, each LOT User and each of its Affiliates referenced in the prior sentence shall remain a Licensor with respect to its Subject Patents, even after submission of a withdrawal announcement as set forth in Section 2.3 or Limitation Announcement as set forth in Exhibit B.

6.11. "LOT Administrator" means LOT Network Inc. or other Entity appointed by LOT Network Inc. or its successor that administers the LOT website, including receiving and publishing on the LOT website the name of Entities that submit this Agreement, withdrawal announcements (as set forth in Section 2.3), Limitation Announcements (as set forth in Exhibit B), and the associated dates of such announcements. The Entity acting as the LOT Administrator may change from time to time as determined by the Board of LOT Network Inc. or its successor and such change will be announced on the LOT website.

6.12. "LOT User" means an Entity that agrees to this Agreement by means of submission to the LOT Administrator. Once an Entity becomes a LOT User, it remains a LOT User for purposes of this Agreement.

6.13. "Participation Period" means, with respect to a particular LOT User and each of its Affiliates, the period commencing on the date such LOT User signs this Agreement and transmits it to the LOT Administrator and ending on the effective date of withdrawal or deemed withdrawal of such LOT User or its respective Affiliate (as set forth in Section 2) or applicable Limitation Date (as set forth in Exhibit B). A LOT User or its Affiliate may have more than one Participation Period, if it withdraws or is deemed to have withdrawn from the Agreement or issues a Limitation Announcement and subsequently re-enters into this Agreement, provided that a withdrawing LOT User under Section 2.3 may not re-enter this Agreement for a period of at least six (6) months after its withdrawal or issuance of a Limitation Announcement.

6.14. "Patent" means any patent, utility model, inventor certificate, or equivalent right, including but not limited to a design patent or design registration, and any application for any of the foregoing anywhere in the world, including originals, continuations, continuations-in-part, divisionals, results of reexamination, renewals, extensions, and reissues, and claims contained in such patent, inventor certificate, utility model, or equivalent.

6.15. "Patent Assertion" means either of the following assertions of rights under a Patent against another Entity: (i) asserting (including but not limited to via a written or oral demand) a claim of Infringement of such Patent for the primary purpose of deriving royalties or other monetary compensation under such Patent, or (ii) the commencement or subsequent pursuit of a claim, action or proceeding in a judicial, administrative or other governmental body, including but not limited to a court (in any country) or the U.S. International Trade Commission, based in whole or in part on a claim of Infringement of such Patent.

6.16. "Products and Services" means, with respect to an Entity, any and all products (hardware and software), technologies, components, and services, including but not limited to any software that is used, licensed or otherwise distributed (including as open source software) by or for the respective Entity, and all authorized copies of same. For purposes of the License granted to each Licensee, Products and Services also include any activities of the Licensee that, in the absence of this Agreement, would constitute inducement to infringe or contributory infringement (or infringement under any other analogous legal doctrine in the applicable jurisdiction) of the Licensors' respective Subject Patent.

6.17. "Subject Patents" means (i) all issued Patents and pending Patent applications owned or licensable (directly or indirectly) by a Licensor at any time during its Participation Period, and (ii) all Patents that at any time issue on or claim priority (directly or indirectly) to any such Patent under (i) above for which Licensor or any assignee, transferee or successor has or later obtains the right to license, whether during or after its Participation Period, *provided* that the grant of a License to an applicable Licensee does not require payment of royalties or other consideration by Licensor to third parties (except for payments among Entities that form part of Licensor or to third parties for inventions made by the third parties while employed by Licensor) unless someone other than Licensor (or its assignees, transferees or successors) agrees to pay such royalties or other consideration on behalf of the applicable Licensee. If a Licensor has any interest in a Patent or an Entity that owns or controls a Patent (including the right to withhold consent for Patent Assertion of such Patent) at any time during its Participation Period, but does not have the right to grant licenses, releases, waivers and immunities of the full scope set forth in this Agreement, then such Patent will be considered a Subject Patent only to the extent Licensor has the right to grant licenses, releases, waivers or immunities within the scope set forth in this Agreement. Licensor grants such licenses, releases, waivers and immunities to the maximum extent it has the right to do so without requiring payment of royalties or other consideration to third parties as set forth above, and agrees to withhold consent for Patent Assertion by any Assertion Entity against any Licensee or with respect to any Licensee's Products and Services to the extent it has the right to do so. Notwithstanding the foregoing, a Patent will not be considered a Subject Patent of a financial institution as defined by 18 U.S.C. § 20 solely by reason of being held by such financial institution (i) as trustee for a beneficiary that is not an Affiliate of such financial institution, or (ii) as a result of foreclosure or enforcement of a security interest in order to transfer the Patent to a third party that is not an Affiliate of such financial institution to satisfy an underlying financial obligation based on monies lent and secured by such Patent.

6.18. "Transfer" or "Transferred" to an Assertion Entity means any of the following with respect to a Subject Patent, whether during or after a Participation Period of the applicable Licensor: (i) the assignment, sale, exclusive license, or transfer, in whole or in part, of such Patent to an Assertion Entity, whether by Licensor or any subsequent transferee or exclusive licensee of the Subject Patent, or (ii) acquisition of ownership or control of the Subject Patent by an Assertion Entity (including any circumstance in which Licensor or any subsequent transferee owning or controlling the Subject Patent is or becomes an Assertion Entity or Controlled by an Assertion Entity or in which any Assertion Entity obtains any right to enforce or otherwise make Patent Assertions of the Subject Patent), with the earliest date any Entity owning or controlling such Patent is or becomes an Assertion Entity or Controlled by an Assertion Entity being deemed to be the effective date of such Transfer. For avoidance of doubt, any condition of a License based on Transfer of a Subject Patent to an Assertion Entity will be deemed satisfied at all times following the date of first Transfer of the Subject Patent to an Assertion Entity, even if the Subject Patent is subsequently transferred to a non-Assertion Entity.

LOT AGREEMENT

SIGNATURE PAGE

By execution of this Agreement through its duly authorized representative below, the Entity identified below, on behalf of itself and its Affiliates, agrees to become a party to this Agreement as a LOT User and to be bound by its terms and conditions (provided such Entity agrees that the LOT Administrator can withhold publishing that such Entity is a LOT User until the LOT Administrator can verify 1) that the individual named below as an authorized representative is in fact a duly authorized representative of the Entity identified below and 2) the Entity's contact information):

Name of LOT User: ____
(Company Name)

Address: ____
(Company Address)

Phone:____

Email:____

Signature of authorized representative:_____________________________

Name of authorized representative: ________________________________

Title of authorized representative: ________________________________

Email (if different from above): __________________________________

Date of signature: ____

LOT AGREEMENT

EXHIBIT A

Fees

A-1 Fee Schedule. The annual fee per LOT User is set forth in the following fee schedule, to be paid to LOT Network Inc. or its successor ("LOT Network") as specified on the LOT website. An Entity that joins part way through LOT Network's fiscal year will pay a pro-rata portion of the annual fee for that year. The pro-rata portion will be due at the time of signing.

Fee Schedule:

LOT User's Annual Revenue	LOT User's Annual Fee
less than $5 million	Free
between $5 million and $10 million	$1,500
between $10 million and $25 million	$2,500
between $25 million and $50 million	$5,000
between $50 million and $100 million	$10,000
between $100 million and $1 billion	$15,000
greater than $1 billion	$20,000

A-2 Updates. The Fee Schedule in Section A-1 of this Exhibit A may be updated from time to time by the Board of Directors of LOT Network in accordance with its Bylaws, and such updates shall not constitute an amendment of this Agreement. The current Fee Schedule will be posted on the LOT website by the LOT Administrator. LOT Network may waive or discount fees from time to time for particular LOT Users or for particular periods of time to attract new LOT Users or for other purposes approved by the Board of Directors of LOT Network in accordance with its Bylaws.

A-3 Failure to Pay Fees. If a LOT User fails to pay the annual membership fee due under this Exhibit A within ninety (90) days of receipt of an invoice, such delinquent LOT User and its Affiliates shall not receive the benefit of any Licenses to any Subject Patents assigned or otherwise transferred by any Licensor to any Entity that is not a LOT User or an Affiliate of a LOT User during a period of delinquency that extends from the date ninety-one (91) days after receipt of such invoice until such delinquency is cured.

EXHIBIT B

Amendments

B-1 Procedure. An amendment may be put to a vote under this Exhibit B only upon approval in writing of the Board of Directors of LOT Network Inc. or its successor ("Board") in accordance with its Bylaws. The Board will determine the amendment submission procedure and the voting procedure and may publish further details on the LOT website. Unless otherwise determined by the Board, the following voting procedure will apply. Following approval of putting an amendment up for vote by the Board as set forth above, the then-current LOT Users qualified to vote will be notified of a proposed amendment via email with no follow-on hardcopy (notwithstanding Section 5.9). Such LOT Users will have 30 calendar days to vote by responding by email to the LOT Administrator at the following email address: admin@lotnet.com. If a LOT User fails to vote within the time period designated, the LOT User's vote will not be counted. If a LOT User joins while an amendment is pending, that LOT User will be permitted to vote on the amendment that is currently pending but the time period to vote will not be extended for such LOT User.

B-2 Approval. Amendment of this Agreement requires vote in favor of the amendment by at least eighty percent (80%) of all LOT Users who timely vote and who, at the time of the vote, are within their Participation Period, have not submitted a Limitation Announcement or announcement of the LOT User's intent to withdraw, have paid any fees due under Exhibit A, and own at least one active, issued US patent in the USPTO assignment database that is a Subject Patent. The terms of an amendment shall take effect upon the date of such approval (the "Amendment Effective Date") which will be published on the LOT website. Notice of such approval will also be given to all LOT Users via email with no follow-on hardcopy (notwithstanding Section 5.9). Upon taking effect, such amended terms shall apply with respect to and amend this Agreement regarding any LOT User and its Affiliates who, by the end of the Publication Period, have not issued a Limitation Announcement as specified below in Sections B-3 of this Exhibit B.

B-3 Dissenting LOT User May Submit a Limitation Announcement. The terms of the amendment shall be published on the LOT website for a period of sixty (60) days after it is approved (the "Publication Period"). Any LOT User that voted against the adoption of such amendment (a "Dissenting LOT User") may submit a written announcement signed and submitted by an authorized representative of the Dissenting LOT User to the LOT website before the end of the applicable Publication Period declaring the Dissenting LOT User's intent to limit the scope of its participation under this Agreement to the terms in effect immediately prior to the Amendment Effective Date and to the Patents of itself and its Affiliates that are Subject Patents hereunder immediately prior to the Amendment Effective Date ("Limitation Announcement"). Any such amended terms shall not apply with respect to any LOT User and its Affiliates who, on or before the end of the applicable Publication Period, have issued a Limitation Announcement. The existence of each Limitation Announcement and the date of its submission will be published on the LOT website.

B-5 Scope of Rights Upon Limitation. The Licenses granted to and by a Dissenting LOT User and its Affiliates will be subject to the terms and conditions of this Agreement in effect immediately prior to the applicable Amendment Effective Date ("Limitation Date"). The Licenses granted to a Dissenting LOT User and its Affiliates will remain in effect after the applicable Limitation Date only with respect to Patents that are Subject Patents of Licensors as of the Limitation Date, including those Transferred to an Assertion Entity after the Limitation Date. All Licenses granted to Licensees with respect to Subject Patents of the Dissenting LOT User and its Affiliates as of the applicable Limitation Date will remain in full force and effect and continue to apply to each Licensee (including those Entities that become an Affiliate of a LOT User after the applicable Limitation Date), including with respect to Subject Patents Transferred to an Assertion Entity after the Limitation Date. For avoidance of doubt, all Patents of a Dissenting LOT User or its Affiliates that are Subject Patents as of its Limitation Date shall remain Subject Patents subject to the terms and conditions of this Agreement after such Limitation Date.

Clicks and More

Intellectual property disputes arise throughout the world and the rights themselves are often critical for whether businesses can succeed or fail. To just highlight a few situations in key IP areas, consider the following:

- *Copyright*: Aereo's internet TV service is built on thousands of tiny antennas and an effort to navigate U.S. copyright law very carefully. You can read background on Aereo here and here and read the Supreme Court's June 2014 opinion condemning the service here.
- *Patents*: Attention on patents has exploded. Two items are especially worthy of attention: the smartphone patent wars and the rise of the patent troll (or, more neutrally, the patent-acquisition entity). On the smartphone patent wars, for background on the U.S. Apple-Samsung dispute, read here as well as the August 24, 2013 jury verdict itself (and my commentary here). And you can sample results in Japan, South Korea and Germany. On patent trolls, you can get one perspective from the White House Blog (June 14, 2013 here) and a second by visiting the website of a prominent firm in this space, Intellectual Ventures.
- *Trade Secrets*: It is frequently said by firms that there most important assets walk out the door each night, but sometimes that is literally true. In May, 2013, The Commission on the Theft of Intellectual Property released its report (see Chapter 5 for background on trade secret theft). Single incidents can generate huge losses for firms (see, for example, the June 27, 2013 press release from the U.S. Department of Justice regarding a trade secret theft resulting an $800 million loss). Congress has responded by boosting penalties in the Foreign and Economic Espionage Penalty Enhancement Act of 2012 (Pub. L. 112-269, Jan. 14, 2013). On May 11, 2016, Congress passed new trade secrets legislation, the Defend Trade Secrets Act of 2016, Pub.L. 114-153.
- *Right of Publicity*: Who gets to control your beautiful face? Notwithstanding the magic of plastic surgery, we don't typically think of faces as being authored, so we aren't in the realm of copyright. Instead, state law creates rules regarding the right of publicity. EA Sports has been embroiled in litigation over these issues regarding its college sports games with two recent court of appeals decisions (*In re NCAA Student-Athlete Name & Likeness Licensing Litigation* (CA9, July 31, 2013) and *Hart v. Electronic Arts* (CA3, May 21, 2013)).

Session 3: Market Power: Antitrust

We will discuss regulatory approaches to market power. In this session, we will look at the antitrust/competition policy approach to market power, while in our next session, we will consider the sort of regulations that we see of natural monopoly in areas such as telecommunications or electricity regulation. For today, we will read chunk of the recent case involving Apple, the iPad and the ebooks market. We then turn to the situation with Google in the European Union. On April 15, 2015, the EU announced a statement of objections regarding one of Google's shopping products and it also announced an investigation into some of Google's practices regarding Android. Roughly one year later, on April 20, 2016, the EU sent Google a statement of objections regarding Android.

United States v. Apple, Inc.

791 F.3d 290 (2nd Cir. 2015)

DEBRA ANN LIVINGSTON, Circuit Judge: Since the invention of the printing press, the distribution of books has involved a fundamentally consistent process: compose a manuscript, print and bind it into physical volumes, and then ship and sell the volumes to the public. In late 2007, Amazon.com, Inc. ("Amazon") introduced the Kindle, a portable device that carries digital copies of books, known as "ebooks." This innovation had the potential to change the centuries-old process for producing books by eliminating the need to print, bind, ship, and store them. Amazon began to popularize the new way to read, and encouraged consumers to buy the Kindle by offering desirable books—new releases and *New York Times* bestsellers—for $9.99. Publishing companies, which have traditionally stood at the center of the multi-billion dollar book-producing industry, saw Amazon's ebooks, and particularly its $9.99 pricing, as a threat to their way of doing business.

By November 2009, Apple, Inc. ("Apple") had plans to release a new tablet computer, the iPad. Executives at the company saw an opportunity to sell ebooks on the iPad by creating a virtual marketplace on the device, which came to be known as the "iBookstore." Working within a tight timeframe, Apple went directly into negotiations with six of the major publishing companies in the United States. In two months, it announced that five of those companies—Hachette, Harpercollins, Macmillan, Penguin, and Simon & Schuster (collectively, the "Publisher Defendants")—had agreed to sell ebooks on the iPad under arrangements whereby the publishers had the authority to set prices, and could set the prices of new releases and *New York Times* bestsellers as high as $19.99 and $14.99, respectively. Each of these agreements, by virtue of its terms, resulted in each Publisher Defendant receiving *less* per ebook sold via Apple as opposed to Amazon, even given the higher consumer prices. Just a few months after the iBookstore opened, however, every one of the Publisher Defendants had taken control over pricing from Amazon and had raised the prices on many of their ebooks, most notably new releases and bestsellers.

The United States Department of Justice ("DOJ" or "Justice Department") and 33 states and territories (collectively, "Plaintiffs") filed suit in the United States District Court for the

Southern District of New York, alleging that Apple, in launching the iBookstore, had conspired with the Publisher Defendants to raise prices across the nascent ebook market. This agreement, they argued, violated § 1 of the Sherman Antitrust Act, 15 U.S.C. § 1 *et seq*. ("Sherman Act"), and state antitrust laws. All five Publisher Defendants settled and signed consent decrees, which prohibited them, for a period, from restricting ebook retailers' ability to set prices. Then, after a three-week bench trial, the district court (Cote, J.) concluded that, in order to induce the Publisher Defendants to participate in the iBookstore and to avoid the necessity of itself competing with Amazon over the retail price of ebooks, Apple orchestrated a conspiracy among the Publisher Defendants to raise the price of ebooks—particularly new releases and *New York Times* bestsellers. *United States v. Apple Inc.*, 952 F. Supp. 2d 638, 647 (S.D.N.Y. 2013). The district court found that the agreement constituted a *per se* violation of the Sherman Act and, in the alternative, unreasonably restrained trade under the rule of reason. On September 5, 2013, the district court entered final judgment on the liability finding and issued an injunctive order that, *inter alia*, prevents Apple from entering into agreements with the Publisher Defendants that restrict its ability to set, alter, or reduce the price of ebooks, and requires Apple to apply the same terms and conditions to ebook applications sold on its devices as it does to other applications.

On appeal, Apple contends that the district court's liability finding was erroneous and that the provisions of the injunction related to its pricing authority and ebook applications are not necessary to protect the public. *** Because we conclude that the district court did not err in deciding that Apple violated § 1 of the Sherman Act, and because we also conclude that the district court's injunction was lawful and consistent with preventing future anticompetitive harms, we affirm.

BACKGROUND

I. Factual Background

We begin not with Kindles and iPads, but with printed "trade books," which are "general interest fiction and non-fiction" books intended for a broad readership. *Apple*, 952 F. Supp. 2d at 648 n.4. In the United States, the six largest publishers of trade books, known in the publishing world as the "Big Six," are Hachette, HarperCollins, Macmillan, Penguin, Random House, and Simon & Schuster. Together, the Big Six publish many of the biggest names in fiction and non-fiction; during 2010, their titles accounted for over 90% of the *New York Times* bestsellers in the United States. *Id.* at 648 n.5.

For decades, trade book publishers operated under a fairly consistent business model. When a new book was ready for release to the public, the publisher would sell hardcover copies to retailers at a "wholesale" price and recommend resale to consumers at a markup, known as the "list" price. After the hardcover spent enough time on the shelves—often a year—publishers would release a paperback copy at lower "list" and "wholesale" prices. In theory, devoted readers would pay the higher hardcover price to read the book when it first came out, while more casual fans would wait for the paperback.

A. Amazon's Kindle

On November 19, 2007, Amazon released the Kindle: a portable electronic device that allows consumers to purchase, download, and read ebooks. At the time, there was only one other ereader available in the emerging ebook market, and Amazon's Kindle quickly gained traction. In 2007, ebook revenue in North America was only $70 million, a tiny amount relative to the approximately $30 billion market for physical trade books. *** Amazon followed a "wholesale" business model similar to the one used with print books: publishers recommended a digital list price and received a wholesale price for each ebook that Amazon sold. In exchange, Amazon could sell the publishers' ebooks on the Kindle and determine the retail price. At least early on, publishers tended to recommend a digital list price that was about 20% lower than the print list price to reflect the fact that, with an ebook, there is no cost for printing, storing, packaging, shipping, or returning the books.

Where Amazon departed from the publishers' traditional business model was in the sale of new releases and *New York Times* bestsellers. Rather than selling more expensive versions of these books upon initial release (as publishers encouraged by producing hardcover books before paperback copies), Amazon set the Kindle price at one, stable figure—$9.99. At this price, Amazon was selling "certain" new releases and bestsellers at a price that "roughly matched," or was slightly lower than, the wholesale price it paid to the publishers. *Apple*, 952 F. Supp. 2d at 649. ***

B. The Publishers' Reactions

Despite the small number of ebook sales compared to the overall market for trade books, top executives in the Big Six saw Amazon's $9.99 pricing strategy as a threat to their established way of doing business. *** In the short term, these members of the Big Six thought that Amazon's lower-priced ebooks would make it more difficult for them to sell hardcover copies of new releases, "which were often priced," as the district court noted, "at thirty dollars or more," *Apple*, 952 F. Supp. 2d at 649, as well as *New York Times* bestsellers. Further down the road, the publishers feared that consumers would become accustomed to the uniform $9.99 price point for these ebooks, permanently driving down the price they could charge for print versions of the books. Moreover, if Amazon became powerful enough, it could demand lower wholesale prices from the Big Six or allow authors to publish directly with Amazon, cutting out the publishers entirely. *** The executives of the Big Six also recognized that their problem was a collective one. ***

The most significant attack that the publishers considered and then undertook, however, was to withhold new and bestselling books from Amazon until the hardcover version had spent several months in stores, a practice known as "windowing." Members of the Big Six both kept one another abreast of their plans to window, and actively pushed others toward the strategy. *** Ultimately, however, the publishers viewed even this strategy to save their business model as self-destructive. Employees inside the publishing companies noted that windowing encouraged piracy, punished ebook consumers, and harmed long-term sales. ***

C. Apple's Entry into the ebook Market

Apple is one of the world's most innovative and successful technology companies. Its hardware sells worldwide and supports major software marketplaces like iTunes and the App Store. But in 2009, Apple lacked a dedicated marketplace for ebooks or a hardware device that could offer an outstanding reading experience. The pending release of the iPad, which Apple intended to announce on January 27, 2010, promised to solve that hardware deficiency.

Eddy Cue, Apple's Senior Vice President of Internet Software and Services and the director of Apple's digital content stores, saw the opportunity for an ebook marketplace on the iPad. *** Jobs approved Cue's plan for an ebook marketplace—which came to be known as the iBookstore—in November 2009. ***

D. Apple's Negotiations with the Publishers

1. Initial Meetings

Apple held its first meetings with each of the Big Six between December 15 and 16. The meetings quickly confirmed Cue's suspicions about the industry. As he wrote to Jobs after speaking with three of the publishers, "[c]learly, the biggest issue is new release pricing" and "Amazon is definitely not liked much because of selling below cost for NYT Best Sellers." J.A. 326-27. Many publishers also emphasized that they were searching for a strategy to regain control over pricing. Apple informed each of the Big Six that it was negotiating with the other major publishers, that it hoped to begin selling ebooks within the next 90 days, and that it was seeking a critical mass of participants in the iBookstore and would launch only if successful in reaching this goal. *** Most importantly for the publishers, however, Cue's team also expressed Apple's belief that Amazon's $9.99 price point was not ingrained in consumers' minds, and that Apple could sell new releases and *New York Times* bestsellers for somewhere between $12.99 and $14.99. In return, Apple requested that the publishers decrease their wholesale prices so that the company could make a small profit on each sale.

These meetings spurred a flurry of communications reporting on the "[t]errific news[,]" as Reidy put it in an email to Leslie Moonves, her superior at parent company CBS Corporation ("CBS"), that Apple "was not interested in a low price point for digital books" and didn't want "Amazon's $9.95 [sic] to continue." *Apple*, 952 F. Supp. 2d at 658 (first alteration in original) (internal quotation marks omitted). Significantly, these communications included numerous exchanges *between* executives at different Big Six publishers who, the district court found, "hashed over their meetings with Apple with one another." *Id.* The district court found that the frequent telephone calls among the Publisher Defendants during the period of their negotiations with Apple "represented a departure from the ordinary pattern of calls among them." *Id.* at 655 n.14.

2. The Agency Model

Meanwhile, Cue, Moerer, and Saul returned to Apple's headquarters to develop a business model for the iBookstore. *** It was at this point that Cue's team, recognizing its opportunity, abandoned the wholesale business model for a new, agency model. Unlike a wholesale model, in an agency relationship the *publisher* sets the price that consumers will pay for each ebook. Then, rather than the retailer paying the publisher for each ebook that it sells, the publisher pays the retailer a fixed percentage of each sale. In essence, the retailer receives a commission for distributing the publisher's ebooks. Under the system Apple devised, publishers would have the freedom to set ebook prices in the iBookstore, and would keep 70% of each sale. The remaining 30% would go to Apple as a commission.

This switch to an agency model obviated Apple's concerns about negotiating wholesale prices with the Big Six while ensuring that Apple profited on every sale. It did not, however, solve all of the company's problems. Because the agency model handed the publishers control over pricing, it created the risk that the Big Six would sell ebooks in the iBookstore at far higher prices than Kindle's $9.99 offering. If the prices were too high, Apple could be left with a brand new marketplace brimming with titles, but devoid of customers.

To solve this pricing problem, Cue's team initially devised two strategies. First, they realized that they could maintain "realistic prices" by establishing price caps for different types of books. J.A. 359. Of course, these caps would need to behigher than Amazon's $9.99 price point, or Apple would face the same difficult price negotiations that it sought to avoid by switching away from the wholesale model. But at this point Apple was not content to open its iBookstore offering prices higher than the competition. ***

Apple next concluded, then, as the district court found, that "[t]o ensure that the iBookstore would be competitive at higher prices, Apple . . . needed to eliminate all retail price competition." *Id.* at 659. Thus, rather than simply agreeing to price caps above Amazon's $9.99 price point, Apple created a second requirement: publishers must switch all of their other ebook retailers—including Amazon—to an agency pricing model. ***

On January 4 and 5, Apple sent essentially identical emails to each member of the Big Six to explain its agency model proposal. Each email described the commission split between Apple and the publishers and recommended three price caps: $14.99 for hardcover books with list prices above $35; $12.99 for hardcover books with list prices below $35; and $9.99 for all other trade books. The emails also explained that, "to sell ebooks at realistic prices . . . all [other] resellers of new titles need to be in [the] agency model" as well. J.A. 360. Or, as Cue told Reidy, "all publishers" would need to move "all retailers" to an agency model. J.A. 2060.

3. The "Most-Favored-Nation" Clause

Cue's thoughts on the agency model continued to evolve after the emails on January 4 and 5. Most significantly, Saul—Cue's in-house counsel—devised an alternative to explicitly requiring publishers to switch other retailers to agency. This alternative involved the use of a "most-favored nation" clause ("MFN Clause" or "MFN"). In general, an MFN Clause is a contractual provision that requires one party to give the other the best terms that it makes available to any competitor. In the context of Apple's negotiations, the MFN Clause mandated that, "[i]f, for any particular New Release in hardcover format, the . . . Customer Price [in the iBookstore] at any time is or becomes higher than a customer price offered by any other reseller . . ., then [the] Publisher shall designate a new, lower Customer Price [in the iBookstore] to meet such lower [customer price].” J.A. 559. Put differently, the MFN would require the publisher to offer any ebook in Apple’s iBookstore for no more than what the same ebook was offered elsewhere, such as from Amazon.

On January 11, Apple sent each of the Big Six a proposed eBook Agency Distribution Agreement (the “Contracts”). As described in the January 4 and 5 emails, these Contracts would split the proceeds from each ebook sale between the publisher and Apple, with the publisher receiving 70%, and would set price caps on ebooks at $14.99, $12.99, and $9.99 depending on the book’s hardcover price. But unlike the initial emails, the Contracts contained MFN Clauses in place of the requirement that publishers move all other retailers to an agency model. Apple then assured each member of the Big Six that it was being offered the same terms as the others.

The Big Six understood the economic incentives that the MFN Clause created. Suppose a new hardcover release sells at a list price of $25, and a wholesale price of $12.50. With Amazon, the publishers had been receiving the wholesale price (or a slightly lower digital wholesale price) for every ebook copy of the volume sold on Kindle, even if Amazon ultimately sold the ebook for less than that wholesale price. Under Apple’s initial agency model—with price caps but no MFN Clause—the publishers already stood to make *less* money per ebook with Apple. Because Apple capped the ebook price of a $25 hardcover at $12.99 and took 30% of that price, publishers could only expect to make $8.75 per sale. But what the publishers sacrificed in short-term revenue, they hoped to gain in long-term stability by acquiring more control over pricing and, accordingly, the ability to protect their hardcover sales.

The MFN Clause changed the situation by making it imperative, not merely desirable, that the publishers wrest control over pricing from ebook retailers generally. Under the MFN, if Amazon stayed at a wholesale model and continued to sell ebooks at $9.99, the publishers would be forced to sell in the iBookstore, too, at that same $9.99 price point. The result would be the worst of both worlds: *lower* short-term revenue and *no* control over pricing. The publishers recognized that, as a practical matter, this meant that the MFN Clause would force them to move Amazon to an agency relationship. *** Apple understood this dynamic as well. *** Cue bluntly put it, “any decent MFN forces the model” away from wholesale and to agency. *Id.* (internal quotation marks omitted). ***

Thus, the terms of the negotiation between Apple and the publishers became clear: Apple wanted quick and successful entry into the ebook market and to eliminate retail price competition with Amazon. In exchange, it offered the publishers an opportunity “to confront Amazon as one of an organized group . . . united in an effort to eradicate the $9.99 price point.” *Id.* at 664. Both sides needed a critical mass of publishers to achieve their goals. The MFN played a pivotal role in this *quid pro quo* by “stiffen[ing] the spines of the [publishers] to ensure that they would demand new terms from Amazon,” and protecting Apple from retail price competition. *Id.* at 665.

4. Final Negotiations

The proposed Contracts sparked intense negotiations as Cue's team raced to assemble enough publishers to announce the iBookstore by January 27. *** In a set of meetings between January 13 and 14, the majority of the Big Six expressed a general willingness to adopt an agency model, but refused to do so with the price limits Apple demanded. Cue responded by asking Jobs for permission to create a more lenient price cap system. Under this new regime, *New York Times* bestsellers could sell for $14.99 if the hardcover was listed above $30, and for $12.99 if listed below that price. As for new releases, a $12.99 cap would apply to hardcovers priced between $25 and $27.50; a $14.99 cap would apply to hardcovers selling for up to $30; and, if the hardcover sold for over $30, publishers could sell the ebook for between $16.99 and $19.99. Jobs responded that he could "live with" the pricing "as long as [the publishers] move Amazon to the agen[cy] model too." J.A. 499.

Cue proposed this new pricing regime to the Big Six on January 16 and, with only 11 days remaining before the iPad launch, turned up the pressure. *** By January 22, two publishers—Simon & Schuster and Hachette—had verbally committed to join the iBookstore, while a third, Penguin, had agreed to Apple's terms in principle. *** To make matters worse, "[p]ress reports on January 18 and 19 alerted the publishing world and Amazon to the Publishers' negotiations with Apple," *Apple*, 952 F. Supp. 2d at 670-71, and Amazon learned from Random House that it was facing "pressure from other publishers . . . to move to [the] agency model because Apple had made it clear that unless all of the Big Six participated, they wouldn't bother with building a bookstore," J.A. 1520. Representatives from Amazon descended on New York for a set of long-scheduled meetings with the publishers. As the district court found, "[i]n separate conversations on January 20 and over the next few days, the Publisher Defendants all told Amazon that they wanted to change to an agency distribution model with Amazon." *Apple*, 952 F. Supp. 2d at 672. ***

HarperCollins was the fifth, and final, publisher to agree in principle to Apple's proposal. Murray, its CEO, "remained unhappy over the size of Apple's commission and the existence of price caps." *Id.* at 673 n.39. Unable to negotiate successfully with Murray, Cue asked Jobs to contact James Murdoch, the CEO of the publisher's parent company, and "tell him we have 3 signed so there is no leap of faith here." *Id.* at 675 (internal quotation marks omitted). After a series of emails, Jobs summarized Apple's position to Murdoch:

> [W]e simply don't think the ebook market can be successful with pricing higher than $12.99 or $14.99. Heck, Amazon is selling these books at $9.99, and who knows, maybe they are right and we will fail even at $12.99. But we're willing to try at the prices we've proposed. . . . As I see it, [HarperCollins] has the following choices: (1) Throw in with [A]pple and see if we can all make a go of this to create a real mainstream ebooks market at $12.99 and $14.99. (2) Keep going with Amazon at $9.99. You will make a bit more money in the short term, but in the medium term Amazon will tell you they will be paying you 70% of $9.99. They have shareholders too. (3) Hold back your books from Amazon. Without a way for customers to buy your ebooks, they will steal them.

Id. at 677. Cue also emailed Murray to inform him that four other publishers had signed their agreements. Murray then called executives at both Hachette and Macmillan before agreeing to Apple's terms.

As the district court found, during the period in January during which Apple concluded its agreements with the Publisher Defendants, "Apple kept the Publisher Defendants apprised about who was in and how many were on board." *Id.* at 673. The Publisher Defendants also kept in close communication. As the district court noted, "[i]n the critical negotiation period, over the three days between January 19 and 21, Murray, Reidy, Shanks, Young, and Sargeant called one another 34 times, with 27 calls exchanged on January 21 alone." *Id.* at 674.

By the January 27 iPad launch, five of the Big Six—Hachette, HarperCollins, Macmillan, Penguin, and Simon & Schuster—had agreed to participate in the iBookstore. The lone holdout, Random House, did not join because its executives believed it would fare better under a wholesale pricing model and were unwilling to make a complete switch to agency pricing. Steve Jobs announced the iBookstore as part of his presentation introducing the iPad. When asked after the presentation why someone should purchase an ebook from Apple for $14.99 as opposed to $9.99 with Amazon or Barnes & Noble, Jobs confidently replied, "[t]hat won't be the case . . . the price will be the same. . . . [P]ublishers will actually withhold their [e]books from Amazon . . . because they are not happy with the price." A day later, Jobs told his biographer the publishers' position with Amazon: "[y]ou're going to sign an agency contract or we're not going to give you the books." J.A. 891 (internal quotation marks omitted).

E. Negotiations with Amazon

Jobs's boast proved to be prophetic. While the Publisher Defendants were signing Apple's Contracts, they were also informing Amazon that they planned on changing the terms of their agreements with it to an agency model. However, their move against Amazon began in earnest on January 28, the day after the iPad launch. That afternoon, John Sargent flew to Seattle to deliver an ultimatum on behalf of Macmillan: that Amazon would switch its ebook sales agreement with Macmillan to an agency model or suffer a seven-month delay in its receipt of Macmillan's new releases. Amazon responded by removing the option to purchase Macmillan's print and ebook titles from its website.

Sargent, as the district court found, had informed Cue of his intention to confront Amazon before ever leaving for Seattle. *Apple*, 952 F. Supp. 2d at 678. On his return, he emailed Cue to inform him about Amazon's decision to remove Macmillan ebooks from Kindle, adding a note to say that he wanted to "make sure you are in the loop." J.A. 640. Sargent also wrote a public letter to Macmillan's authors and agents, describing the Amazon negotiations. Hachette's Arnaud Nourry emailed the CEO of Macmillan's parent company to express his "personal support" for Macmillan's actions and to "ensure [him] that [he was] not going to find [his] company alone in the battle." J.A. 643. A Penguin executive wrote to express similar support for Macmillan's position.

The district court found that while Amazon was "opposed to adoption of the agency model and did not want to cede pricing authority to the Publishers," it knew that it could not prevail in this position against five of the Big Six. *Apple*, 952 F. Supp. 2d at 671, 680. When Amazon told Macmillan that it would be willing to negotiate agency terms, Sargent sent Cue an email titled "URGENT!!" that read: "Hi Eddy, I am gonna need to figure out our final agency terms of sale tonight. Can you call me please?" J.A. 642. Cue and Sargent spoke that night and, while Cue denied at trial that the conversation concerned Macmillan's negotiations with Amazon, the district court found that "his denial was not credible." *Apple*, 952 F. Supp. 2d at 681 n.52. By February 5, Amazon had agreed to agency terms with Macmillan.

The other publishers who had joined the iBookstore quickly followed Macmillan's lead. *** Once again, Apple closely monitored the negotiations with Amazon. The Publisher Defendants would inform Cue when they had completed agency agreements, and his team monitored price changes on the Kindle. ***

F. Effect on Ebook Prices

As Apple and the Publisher Defendants expected, the iBookstore price caps quickly became the benchmark for ebook versions of new releases and *New York Times* bestsellers. In the five months following the launch of the iBookstore, the publishers who joined the marketplace and switched Amazon to an agency model priced 85.7% of new releases on Kindle and 92.1% of new releases on the iBookstore at, or just below, the price caps. *Apple*, 952 F. Supp. 2d at 682. Prices for *New York Times* bestsellers took a similar leap as publishers began to sell 96.8% of their bestsellers on Kindle and 99.4% of their bestsellers on the iBookstore at, or just below, the Apple price caps *Id.* During that same time period, Random House, which had not switched to an agency model, saw virtually no change in the prices for its new releases or *New York Times* bestsellers.

*** Based on data from February 2010—just before the Publisher Defendants switched Amazon to agency pricing—to February 2011, an expert retained by the Justice Department observed that the weighted average price of the Publisher Defendants' new releases increased by 24.2%, while bestsellers increased by 40.4%, and other ebooks increased by 27.5%, for a total weighted average ebook price increase of 23.9%. Indeed, even Apple's expert agreed, noting that, over a two-year period, the Publisher Defendants increased their average prices for hardcovers, new releases, and other ebooks. ***

II. Apple's Liability Under § 1

This appeal requires us to address the important distinction between "horizontal" agreements to set prices, which involve coordination "between competitors at the same level of [a] market structure," and "vertical" agreements on pricing, which are created between parties "at different levels of [a] market structure." *Anderson News, L.L.C. v. Am. Media, Inc.*, 680 F.3d 162, 182 (2d Cir. 2012) (internal quotation marks omitted). Under § 1 of the Sherman Act, the former are, with limited exceptions, per se unlawful, while the latter are unlawful only if an assessment of market effects, known as a rule-of-reason analysis, reveals that they unreasonably restrain trade. ***

Apple characterizes its Contracts with the Publisher Defendants as a series of parallel but independent vertical agreements, a characterization that forms the basis for its two primary arguments against the district court's decision. *** For the reasons set forth below, we reject these arguments. On this record, the district court did not err in determining that Apple orchestrated an agreement with and among the Publisher Defendants, in characterizing this agreement as a horizontal price fixing-conspiracy, or in holding that the conspiracy unreasonably restrained trade in violation of § 1 of the Sherman Act.

A. The Conspiracy with the Publisher Defendants

Section 1 of the Sherman Act bans restraints on trade "effected by a contract, combination, or conspiracy." *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 553 (2007) (internal quotation marks omitted). The first "crucial question in a Section 1 case is therefore whether the challenged conduct 'stem[s] from independent decision or from an agreement, tacit or express.'" *Starr v. Sony BMG Music Entm't*, 592 F.3d 314, 321 (2d Cir. 2010) (alteration in original) (quoting *Theatre Enters., Inc. v. Paramount Film Distrib. Corp.*, 346 U.S. 537, 540 (1954)).

Identifying the existence and nature of a conspiracy requires determining whether the evidence "reasonably tends to prove that the [defendant] and others had a conscious commitment to a common scheme designed to achieve an unlawful objective." *Monsanto Co. v. Spray-Rite Serv. Corp.*, 465 U.S. 752, 764 (1984) (internal quotation marks omitted). Parallel action is not, by itself, sufficient to prove the existence of a conspiracy; such behavior could be the result of "coincidence, independent responses to common stimuli, or mere interdependence unaided by an advance understanding among the parties." *Twombly*, 550 U.S. at 556 n.4 (internal quotation marks omitted). Indeed, parallel behavior that does not result from an agreement is not unlawful even if it is anticompetitive. Accordingly, to prove an antitrust conspiracy, "a plaintiff must show the existence of additional circumstances, often referred to as 'plus' factors, which, when viewed in conjunction with the parallel acts, can serve to allow a fact-finder to infer a conspiracy." *Apex Oil Co. v. DiMauro*, 822 F.2d 246, 253 (2d Cir. 1987).

*** Because of the risk of condemning parallel conduct that results from independent action and not from an actual unlawful agreement, the Supreme Court has cautioned against drawing an inference of conspiracy from evidence that is equally consistent with independent conduct as with illegal conspiracy—or, as the Court has called it, "ambiguous" evidence. *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 597 n.21 (1986).

*** Apple's basic argument is that because its Contracts with the Publisher Defendants were fully consistent with its independent business interests, those agreements provide only "ambiguous" evidence of a § 1 conspiracy, and the district court therefore erred under *Matsushita* and *Monsanto* in inferring such a conspiracy.

We disagree. At the start, Apple's benign portrayal of its Contracts with the Publisher Defendants is not persuasive—not because those Contracts themselves were independently unlawful, but because, in context, they provide strong evidence that Apple consciously orchestrated a conspiracy among the Publisher Defendants. As explained below, and as the district court concluded, Apple understood that its proposed Contracts were attractive to the Publisher Defendants *only* if they collectively shifted their relationships with Amazon to an agency model—which Apple knew would result in higher consumer-facing ebook prices. In addition to these Contracts, moreover, ample additional evidence identified by the district court established both that the Publisher Defendants' shifting to an agency model with Amazon was the result of express collusion among them and that Apple consciously played a key role in organizing that collusion. The district court did not err in concluding that Apple was more than an innocent bystander.

Apple offered each Big Six publisher a proposed Contract that would be attractive only if the publishers acted collectively. Under Apple's proposed agency model, the publishers stood to make less money per sale than under their wholesale agreements with Amazon, but the Publisher Defendants were willing to stomach this loss because the model allowed them to sell new releases and bestsellers for more than $9.99. Because of the MFN Clause, however, each new release and bestseller sold in the iBookstore would cost only $9.99 as long as Amazon continued to sell ebooks at that price. So in order to receive the perceived benefit of Apple's proposed Contracts, the Publisher Defendants had to switch Amazon to an agency model as well—something no individual publisher had sufficient leverage to do on its own. Thus, each Publisher Defendant would be able to accomplish the shift to agency—and therefore have an incentive to sign Apple's proposed Contracts—only if it acted in tandem with its competitors. By the very act of signing a Contract with Apple containing an MFN Clause, then, each of the Publisher Defendants signaled a clear commitment to move against Amazon, thereby facilitating their collective action. ***

The Supreme Court has defined an agreement for Sherman Act § 1 purposes as "a conscious commitment to a common scheme designed to achieve an unlawful objective." *Monsanto*, 465 U.S. at 764 (internal quotation marks omitted). Plainly, this use of the promise of higher prices as a bargaining chip to induce the Publisher Defendants to participate in the iBookstore constituted a conscious commitment to the goal of raising ebook prices. *** Nor was the Publisher Defendants' joint action against Amazon a result of parallel decisionmaking. *** That the Publisher Defendants were in constant communication regarding their negotiations with both Apple and Amazon can hardly be disputed. Indeed, Apple never seriously argues that the Publisher Defendants were not acting in concert.

*** Apple's involvement in the conspiracy continued even past the signing of its agency agreements. Before Sargent flew to Seattle to meet with Amazon, he told Cue. Apple stayed abreast of the Publisher Defendants' progress as they set coordinated deadlines with Amazon and shared information with one another during negotiations. ***

Apple responds to this evidence—which the experienced judge who oversaw the trial characterized repeatedly as "overwhelming"—by explaining how each piece of evidence standing alone is "ambiguous" and therefore insufficient to support an inference of conspiracy. We are not persuaded. *** Combined with the unmistakable purpose of the Contracts that Apple proposed to the publishers, and with the collective move against Amazon that inevitably followed the signing of those Contracts, the emails and phone records demonstrate that Apple *agreed* with the Publisher Defendants, within the meaning of the Sherman Act, to raise consumer-facing ebook prices by eliminating retail price competition. The district court did not err in rejecting Apple's argument that the evidence of its orchestration of the Publisher Defendants' conspiracy was "ambiguous."

*** In short, we have no difficulty on this record rejecting Apple's argument that the district court erred in concluding that Apple "conspir[ed] with the Publisher Defendants to eliminate retail price competition and to raise e-book prices." *Apple*, 952 F. Supp. 2d at 691. Having concluded that the district court correctly identified an agreement between Apple and the Publisher Defendants to raise consumer-facing ebook prices, we turn to Apple's and the dissent's arguments that this agreement did not violate § 1 of the Sherman Act.

B. Unreasonable Restraint of Trade

"Although the Sherman Act, by its terms, prohibits every agreement 'in restraint of trade,' [the Supreme] Court has long recognized that Congress intended to outlaw only unreasonable restraints." *State Oil Co. v. Khan*, 522 U.S. 3, 10 (1997).***

In antitrust cases, "*[p]er se* and rule-of-reason analysis are . . . two methods of determining whether a restraint is 'unreasonable,' *i.e.*, whether its anticompetitive effects outweigh its procompetitive effects." *Atl. Richfield Co. v. USA Petroleum Co.*, 495 U.S. 328, 342 (1990). *** Horizontal price-fixing conspiracies traditionally have been, and remain, the "archetypal example" of a *per se* unlawful restraint on trade. *Catalano, Inc. v. Target Sales, Inc.*, 446 U.S. 643, 647 (1980). By contrast, the Supreme Court in recent years has clarified that vertical restraints—including those that restrict prices—should generally be subject to the rule of reason.

In this case, the district court held that the agreement between Apple and the Publisher Defendants was unlawful under the *per se* rule; in the alternative, even assuming that a rule-of-reason analysis was required, the district court concluded that the agreement was still unlawful.

1. Whether the *Per Se* Rule Applies

a. Horizontal Agreement

In light of our conclusion that the district court did not err in determining that Apple organized a price-fixing conspiracy among the Publisher Defendants, Apple and the dissent's initial argument against the *per se* rule—that Apple's conduct must be subject to rule-of-reason analysis because it involved merely multiple independent, vertical agreements with the Publisher Defendants—cannot succeed.

"The true test of legality" under § 1 of the Sherman Act "is whether the *restraint imposed* is such as merely regulates and perhaps thereby promotes competition or whether it is such as may suppress or even destroy competition." *Bd. of Trade of City of Chi. v. United States*, 246 U.S. 231, 238 (1918) (emphasis added). By agreeing to orchestrate a horizontal price-fixing conspiracy, Apple committed itself to "achiev[ing] [that] unlawful objective," *Monsanto*, 465 U.S. at 764 (internal quotation marks omitted): namely, collusion with and among the Publisher Defendants to set ebook prices. This type of agreement, moreover, is a restraint "that would always or almost always tend to restrict competition and decrease output." *Leegin*, 551 U.S. at 886 (internal quotation marks omitted).

The response, raised by Apple and our dissenting colleague, that Apple engaged in "vertical conduct" that is unfit for *per se* condemnation therefore misconstrues the Sherman Act analysis. It is the type of restraint Apple agreed to impose that determines whether the *per se* rule or the rule of reason is appropriate. These rules are means of evaluating "whether [a] *restraint* is unreasonable," not the reasonableness of a particular defendant's role in the scheme. *Atl. Richfield*, 495 U.S. at 342 (emphasis added) (internal quotation marks omitted).

Consistent with this principle, the Supreme Court and our Sister Circuits have held all participants in "hub-and-spoke" conspiracies liable when the objective of the conspiracy was a *per se* unreasonable restraint of trade. ***

Because the reasonableness of a restraint turns on its anticompetitive effects, and not the identity of each actor who participates in imposing it, Apple and the dissent's observation that the Supreme Court has refused to apply the *per se* rule to certain vertical agreements is inapposite. The rule of reason is unquestionably appropriate to analyze an agreement between a manufacturer and its distributors to, for instance, limit the price at which the distributors sell the manufacturer's goods or the locations at which they sell them. *See Leegin*, 551 U.S. at 881; *Cont'l T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 57 (1977). These vertical restrictions "are widely used in our free market economy," can enhance interbrand competition, and do not inevitably have a "pernicious effect on competition." *Cont'l T.V.*, 433 U.S. at 57-58 (internal quotation marks omitted). But the relevant "agreement in restraint of trade" in this case is not Apple's vertical Contracts with the Publisher Defendants (which might well, if challenged, have to be evaluated under the rule of reason); it is the horizontal agreement that Apple organized among the Publisher Defendants to raise ebook prices. As explained below, horizontal agreements with the purpose and effect of raising prices are *per se* unreasonable because they pose a "threat to the central nervous system of the economy," *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150, 224 n.59 (1940); that threat is just as significant when a vertical market participant organizes the conspiracy. Indeed, as the dissent notes, the Publisher Defendants' coordination to fix prices is uncontested on appeal. The competitive effects of that *same restraint* are no different merely because a different conspirator is the defendant.

Accordingly, when the Supreme Court has applied the rule of reason to vertical agreements, it has explicitly distinguished situations in which a vertical player organizes a horizontal cartel. ***

A horizontal conspiracy can use vertical agreements to facilitate coordination without the other parties to those agreements knowing about, or agreeing to, the horizontal conspiracy's goals. *** But there is no such possibility for confusion in the hub-and-spoke context, where the vertical organizer has not only committed to vertical agreements, but has also agreed to participate in the horizontal conspiracy. In that situation, the court need not consider whether the vertical agreements restrained trade because all participants agreed to the horizontal restraint, which is "and ought to be, *per se* unlawful." *Id.*

In short, the relevant "agreement in restraint of trade" in this case is the price-fixing conspiracy identified by the district court, not Apple's vertical contracts with the Publisher Defendants. How the law might treat Apple's vertical agreements in the absence of a finding that Apple agreed to create the horizontal restraint is irrelevant. Instead, the question is whether the vertical organizer of a horizontal conspiracy designed to raise prices has agreed to a restraint that is any less anticompetitive than its co-conspirators, and can therefore escape *per se* liability. We think not. Even in light of this conclusion, however, we must address two additional arguments that Apple raises against application of the *per se* rule.

b. "Enterprise and Productivity"

Apple seeks refuge from the *per se* rule by invoking a line of cases in which courts have permitted defendants to introduce procompetitive justifications for horizontal price-fixing arrangements that would ordinarily be condemned *per se* if those agreements "when adopted could reasonably have been believed to promote 'enterprise and productivity.'" Apple Br. at 50 (quoting *In re Sulfuric Acid Antitrust Litig.*, 703 F.3d 1004, 1011 (7th Cir. 2012)) (internal quotation mark omitted). ***

Put differently, a participant in a price-fixing agreement may invoke only certain, limited *kinds* of "enterprise and productivity" to receive the rule of reason's advantages. As the Supreme Court has explained—including in *BMI* itself, *see* 441 U.S. at 8 & n.11—the *per se* rule would lose all the benefits of being "*per se*" if conspirators could seek to justify their conduct on the basis of its purported competitive benefits in every case. Here, there was no joint venture or other similar productive relationship between any of the participants in the conspiracy that Apple joined. Apple also does not claim, nor could it, that creating an ebook retail market is possible only if the participating publishers coordinate with one another on price.

c. Price-Fixing Conspiracy

As noted, the Supreme Court has for nearly 100 years held that horizontal collusion to raise prices is the "archetypal example" of a *per se* unlawful restraint of trade. *Catalano*, 446 U.S. at 647. If successful, these conspiracies concentrate the power to set prices among the conspirators, including the "power to control the market and to fix arbitrary and unreasonable prices." *United States v. Trenton Potteries Co.*, 273 U.S. 392, 397 (1927). And even if unsuccessful or "not . . . aimed at complete elimination of price competition," the conspiracies pose a "threat to the central nervous system of the economy" by creating a dangerously attractive opportunity for competitors to enhance their power at the expense of others. *Socony-Vacuum Oil*, 310 U.S. at 224 n.59 (1940).***

Apple and its amici argue that the horizontal agreement among the publishers was not actually a "price-fixing" conspiracy that deserves *per se* treatment in the first place. But it is well established that *per se* condemnation is not limited to agreements that literally set or restrict prices. Instead, any conspiracy "formed for the purpose and with the effect of raising, depressing, fixing, pegging, or stabilizing the price of a commodity . . . is illegal per se," and the precise "machinery employed . . . is immaterial." *Socony-Vacuum Oil*, 310 U.S. at 223. The conspiracy among Apple and the Publisher Defendants comfortably qualifies as a horizontal price-fixing conspiracy.

As we have already explained, the Publisher Defendants' primary objective in expressly colluding to shift the entire ebook industry to an agency model (with Apple's help) was to eliminate Amazon's $9.99 pricing for new releases and bestsellers, which the publishers believed threatened their short-term ability to sell hardcovers at higher prices and the long-term consumer perception of the price of a new book. They had grown accustomed to a business in which they rarely competed with one another on price and could, at least partially, control the price of new releases and bestsellers by releasing hardcover copies before paperbacks. Amazon, and the ebook, upset that model, and reduced prices to consumers by eliminating the need to print, store, and ship physical volumes. Its $9.99 price point for new releases and bestsellers represented a small loss on a small percentage of its sales designed to encourage consumers to adopt the new technology.

Faced with downward pressure on prices but unconvinced that withholding books from Amazon was a viable strategy, the Publisher Defendants—their coordination orchestrated by Apple—combined forces to grab control over price. Collectively, the Publisher Defendants accounted for 48.8% of ebook sales in 2010. J.A. 1571. Once organized, they had sufficient clout to demand control over pricing, in the form of agency agreements, from Amazon and other ebook distributors. This control over pricing facilitated their ultimate goal of raising ebook prices to the price caps. In other words, the Publisher Defendants took by collusion what they could not win by competition. And Apple used the publishers' frustration with Amazon's $9.99 pricing as a bargaining chip in its negotiations and structured its Contracts to coordinate their push to raise prices throughout the industry. A coordinated effort to raise prices across the relevant market was present in every chapter of this story.

This conspiracy to raise prices also had its intended effect. Immediately after the Publisher Defendants switched Amazon to an agency model, they increased the Kindle prices of 85.7% of their new releases and 96.8% of their *New York Times* bestsellers to within 1% of the Apple price caps. They also increased the prices of their other ebook offerings. Within two weeks of the move to agency, the weighted average price of the Publisher Defendants' ebooks—which accounted for just under half of all ebook sales in 2010—had increased by 18.6%, while the prices for Random House and other publishers remained relatively stable.

This sudden increase in prices reduced ebook sales by the Publisher Defendants and proved to be durable. One analysis compared two-week periods before and after the Publisher Defendants took control over pricing and found that they sold 12.9% fewer ebooks after the switch. Another expert for Plaintiffs conducted a regression analysis, which showed that, over a six-month period following the switch, the Publisher Defendants sold 14.5% fewer ebooks than they would have had the price increases not occurred. Nonetheless, ebook prices for the Publisher Defendants over those six months, controlling for other factors, remained 16.8% higher than before the switch. And even Apple's expert produced a chart showing that the Publisher Defendants' prices for new releases, bestsellers, and other offerings remained elevated a full two years after they took control over pricing.

Apple points out that, in the two years following the conspiracy, prices across the ebook market as a whole fell slightly and total output increased. However, when the agreement at issue involves price fixing, the Supreme Court has consistently held that courts need not even conduct an extensive analysis of "market power" or a "detailed market analysis" to demonstrate its anticompetitive character. *FTC v. Ind. Fed'n of Dentists*, 476 U.S. 447, 460 (1986). The district court's assessment of Apple's and the Publisher Defendants' motives, coupled with the unambiguous increase in the prices of their ebooks, was sufficient to confirm that price fixing was the goal, and the result, of the conspiracy.

Moreover, Apple's evidence regarding long-term growth and prices in the ebook industry is not inconsistent with the conclusion that the price-fixing conspiracy succeeded in actually raising prices. *** No court can presume to know the proper price of an ebook, but the long judicial experience applying the Sherman Act has shown that "[a]ny combination which tampers with price structures . . . would be directly interfering with the free play of market forces." *Socony-Vacuum Oil*, 310 U.S. at 221. By setting new, durable prices through collusion rather than competition, Apple and the Publisher Defendants imposed their view of proper pricing, supplanting the market's free play. This evidence, viewed in conjunction with the district court's findings as to and analysis of the conspiracy's history and purpose, is sufficient to support the conclusion that the agreement to raise ebook prices was a *per se* unlawful price-fixing conspiracy.

2. Rule of Reason

As explained above, neither Apple nor the dissent has presented any particularly strong reason to think that the conspiracy we have identified should be spared *per se* condemnation. My concurring colleague would therefore affirm the district court's decision on that basis alone. I, too, believe that *per se* condemnation is appropriate in this case and view Apple's sloganeering references to "innovation" as a distraction from the straightforward nature of the conspiracy proven at trial. Nonetheless, I am mindful of Apple's argument that the nascent ebook industry has some new and unusual features and that the *per se* rule is not fit for "business relationships where the economic impact of certain practices is not immediately obvious." *Leegin*, 551 U.S. at 887 (internal quotation marks omitted). I therefore assume, for the sake of argument, that it is appropriate to apply the rule of reason and to analyze the competitive effects of Apple's horizontal agreement with the Publisher Defendants.

Notably, however, the ample evidence here concerning the purpose and effects of Apple's agreement with the Publisher Defendants affects the scope of the rule-of-reason analysis called for in this case. Under a prototypically robust rule-of-reason analysis, the plaintiff must demonstrate an "*actual* adverse effect" on competition in the relevant market before the "burden shifts to the defendants to offer evidence of the pro-competitive effects of their agreement." *Geneva Pharms. Tech. Corp. v. Barr Labs. Inc.*, 386 F.3d 485, 506-07 (2d Cir. 2004) (internal quotation marks omitted). The factfinder then weighs the competing evidence "to determine if the effects of the challenged restraint tend to promote or destroy competition."*Id.* at 507. ***

Apple's initial argument that its agreement with the Publisher Defendants was procompetitive (an argument presented principally in an amicus brief adopted wholeheartedly by the dissent) is that by eliminating Amazon's $9.99 price point, the agreement enabled Apple and other ebook retailers to enter the market and challenge Amazon's dominance. But this defense—that higher prices enable more competitors to enter a market—is no justification for a horizontal price-fixing conspiracy. ***

From this perspective, the dissent's contention that Apple could not have entered the ebook retail market without the price-fixing conspiracy, because it could not have profited either by charging more than Amazon or by following Amazon's pricing, is a complete non sequitur. The posited dilemma is the whole point of competition: if Apple could not turn a profit by selling new releases and bestsellers at $9.99, or if it could not make the iBookstore and iPad so attractive that consumers would pay more than $9.99 to buy and read those ebooks on its platform, then there was no place for its platform in the ebook retail market. Neither the district court nor Plaintiffs had an obligation to identify a "viable alternative" for Apple's profitable entry because Apple had no entitlement to enter the market on its preferred terms.

*** In actuality, the district court's fact-finding illustrates that Apple organized the Publisher Defendants' price-fixing conspiracy not because it was a necessary precondition to market entry, but because it was a convenient bargaining chip. Apple was operating under a looming deadline and recognized that, by aligning its interests with those of the Publisher Defendants and offering them a way to raise prices across the ebook market, it could gain quick entry into the market on extremely favorable terms, including the elimination of retail price competition from Amazon. But the offer to orchestrate a horizontal conspiracy to raise prices is not a legitimate way to sweeten a deal.

*** To summarize, the district court made no finding that a horizontal conspiracy to eliminate price competition in the ebook retail market was necessary to bring more retailers into the market to challenge Amazon, nor does the record evidence support this conclusion. More importantly, even if there *were* such evidence, the fact that a competitor's entry into the market is contingent on a horizontal conspiracy to raise prices only means (absent monopolistic conduct by the market's dominant firm, which cannot lawfully be challenged by collusion) that the competitor is inefficient, *i.e.*, that its entry will not enhance consumer welfare. For these reasons, I would reject the argument that Apple's entry into the market represented an important procompetitive benefit of the horizontal price-fixing conspiracy it orchestrated.

*** Accordingly, I agree with the district court's decision that, under the rule of reason, the horizontal agreement to raise consumer-facing ebook prices that Apple orchestrated unreasonably restrained trade. But given the clear applicability of the *per se* rule in this context, the analysis here is largely offered in response to the dissent. I also confidently join with my concurring colleague in affirming the district court's conclusion that Apple committed a *per se* violation of § 1 of the Sherman Act.

CONCLUSION

We have considered the appellants' remaining arguments and find them to be without merit. Because we conclude that Apple violated § 1 of the Sherman Act by orchestrating a horizontal conspiracy among the Publisher Defendants to raise ebook prices, and that the injunctive relief ordered by the district court is appropriately designed to guard against future anticompetitive conduct, the judgment of the district court is AFFIRMED.

LOHIER, Circuit Judge, Concurring in part and Concurring in the judgment: I join in the majority opinion except for part II.B.2 relating to the application of the rule of reason. In my view, Apple's appeal rises or falls based on the application of the *per se* rule. That rule clearly applies to the central agreement in this case (and the only agreement alleged to be unlawful): the publishers' horizontal agreement to fix ebook prices. ***

DENNIS JACOBS, Circuit Judge, Dissenting. I respectfully dissent. This appeal is taken by Apple Inc. from a judgment in the United States District Court for the Southern District of New York (Cote, J.), awarding an antitrust injunction in favor of the United States, 31 states, the District of Columbia, and the Commonwealth of Puerto Rico. The plaintiffs' claims are premised on Apple's conduct as a prospective retailer of e-books. I vote to reverse. *** In the course of this litigation, three theories have been offered for how Apple could have entered the e-book market on less restrictive terms. Each theory misapprehends the market or the law, or both. The absence of alternative means bespeaks the reasonableness of the measures Apple took.

Theory 1: Apple could have competed with Amazon on Amazon's terms, using wholesale contracts and below-cost pricing.

This was never an option. The district court found as fact that: a new entrant into the e-book retail market "would run the risk of losing money if it tried or was forced to match Amazon's pricing to remain competitive," *Apple I*, 952 F. Supp. 2d at 658; Apple was "not willing" to engage in below-cost pricing, *Id.* at 657; and Apple could have avoided this money-losing price structure simply by forgoing entry to the market, see *Id.* at 659. Even if Apple had been willing to adopt below-cost pricing, the result at best would have been duopoly, and the hardening of the existing barrier to entry. Antitrust law disfavors a durable duopoly nearly as much as monopoly itself.

Theory 2: Apple could have entered the e-book retail market using the wholesale model and charged higher prices than Amazon's.

The district court foreclosed this theory as well; it found that Apple refused to impair its brand by charging "what it considered unrealistically high prices." *Apple I*, 952 F. Supp. 2d at 659. Even if Apple had been willing to tarnish its brand by offering bad value for money, the notion that customers would actually have bought e-books from Apple at the higher price defies the law of demand. Higher prices may stimulate sales of certain wines and perfumes—not e-books.

Nor could Apple justify higher prices for the e-books by competing on the basis of its new hardware, the iPad, because there is inter-operability among platforms. And if Apple had attempted to pursue this hardware-based competition by programming its iPad to run the iBookstore but to reject Amazon's Kindle application, Apple might have been exposed to an entirely different antitrust peril. See *United States v. Microsoft Corp.*, 253 F.3d 34, 50-80 (D.C. Cir. 2001) (en banc); Google Android, No. 40099 (Eur. Comm'n Apr. 15, 2015) (antitrust proceedings brought by European Commissioner for Competition against Google for favoring Google's own applications on mobile devices that use Google's operating system).

Theory 3: Apple could have asked the Department of Justice to act against Amazon's monopoly.

Counsel for the United States actually proposed this at oral argument. At the same time, however, he conceded that the Department of Justice had already "noticed" Amazon's e-book pricing and had chosen not to challenge it because the government "regarded it as good for consumers." Any request from Apple would therefore have been futile. True, Apple could not have known that the Antitrust Division would have adopted the position that below-cost pricing is not a concern of antitrust policy: who could have guessed that the government would adopt a policy that is primitive as a matter of antitrust doctrine and illiterate as a matter of economics? Nevertheless, hindsight reveals that government antitrust enforcement against Amazon was not an option.

More fundamentally, litigation is not a *market* alternative. This observation has especial force in markets that are undergoing rapid technological advance, where the competitive half-life of a product is considerably more brief than the span of antitrust litigation. A requirement that potential market entrants litigate instead of enter the market on restrictive (but legal and reasonable) terms, would license monopoly for the duration.

Apple took steps to compete with a monopolist and open the market to more entrants, generating only minor competitive restraints in the process. Its conduct was eminently reasonable; no one has suggested a viable alternative. "What could be more perverse than an antitrust doctrine that discouraged new entry into highly concentrated markets?" *In re Text Messaging Antitrust Litig.*, 782 F.3d 867, 874 (7th Cir. 2015).

Application of the rule of reason easily absolves Apple of antitrust liability. That is why at oral argument the government analogized this case to a drug conspiracy, in which every player is a criminal—at every level, on every axis, whether big or small, whether new entrant or recidivist. The government found the analogy useful—and necessary—because in an all-criminal industry there is no justification or harbor under a rule of reason. ***

European Commission - Press release

Antitrust: Commission fines Google €2.42 billion for abusing dominance as search engine by giving illegal advantage to own comparison shopping service

Brussels, 27 June 2017

The European Commission has fined Google €2.42 billion for breaching EU antitrust rules. Google has abused its market dominance as a search engine by giving an illegal advantage to another Google product, its comparison shopping service.

The company must now end the conduct within 90 days or face penalty payments of up to 5% of the average daily worldwide turnover of Alphabet, Google's parent company.

Commissioner Margrethe **Vestager,** in charge of competition policy, said: "*Google has come up with many innovative products and services that have made a difference to our lives. That's a good thing. But Google's strategy for its comparison shopping service wasn't just about attracting customers by making its product better than those of its rivals. Instead, Google abused its market dominance as a search engine by promoting its own comparison shopping service in its search results, and demoting those of competitors.*

What Google has done is illegal under EU antitrust rules. It denied other companies the chance to compete on the merits and to innovate. And most importantly, it denied European consumers a genuine choice of services and the full benefits of innovation."

Google's strategy for its comparison shopping service

Google's flagship product is the Google search engine, which provides search results to consumers, who pay for the service with their data. Almost 90% of Google's revenues stem from adverts, such as those it shows consumers in response to a search query.

In 2004 Google entered the separate market of comparison shopping in Europe, with a product that was initially called "Froogle", re-named "Google Product Search" in 2008 and since 2013 has been called "Google Shopping". It allows consumers to compare products and prices online and find deals from online retailers of all types, including online shops of manufacturers, platforms (such as Amazon and eBay), and other re-sellers.

When Google entered comparison shopping markets with Froogle, there were already a number of established players. Contemporary evidence from Google shows that the company was aware that Froogle's market performance was relatively poor (one internal document from 2006 stated "*Froogle simply doesn't work*").

Comparison shopping services rely to a large extent on traffic to be competitive. More traffic leads to more clicks and generates revenue. Furthermore, more traffic also attracts more retailers that want to list their products with a comparison shopping service. Given Google's dominance in general internet search, its search engine is an important source of traffic for comparison shopping services.

From 2008, Google began to implement in European markets a fundamental change in strategy to push its comparison shopping service. This strategy relied on Google's dominance in general internet search, instead of competition on the merits in comparison shopping markets:

- **Google has systematically given prominent placement to its own comparison shopping service**: when a consumer enters a query into the Google search engine in relation to which Google's comparison shopping service wants to show results, these are displayed at or near the top of the search results.
- **Google has demoted rival comparison shopping services in its search results**: rival comparison shopping services appear in Google's search results on the basis of Google's generic search algorithms. Google has included a number of criteria in these algorithms, as a result of which rival comparison shopping services are demoted. Evidence shows that even the most highly ranked rival service appears on average only on page four of Google's search results, and others appear even further down. Google's own comparison shopping service is not subject to Google's

generic search algorithms, including such demotions.

As a result, Google's comparison shopping service is much more visible to consumers in Google's search results, whilst rival comparison shopping services are much less visible.

The evidence shows that consumers click far more often on results that are more visible, i.e. the results appearing higher up in Google's search results. Even on a desktop, the ten highest-ranking generic search results on page 1 together generally receive approximately 95% of all clicks on generic search results (with the top result receiving about 35% of all the clicks). The first result on page 2 of Google's generic search results receives only about 1% of all clicks. This cannot just be explained by the fact that the first result is more relevant, because evidence also shows that moving the first result to the third rank leads to a reduction in the number of clicks by about 50%. The effects on mobile devices are even more pronounced given the much smaller screen size.

This means that by giving prominent placement only to its own comparison shopping service and by demoting competitors, Google has given its own comparison shopping service a significant advantage compared to rivals.

Breach of EU antitrust rules

Google's practices amount to an abuse of Google's dominant position in general internet search by stifling competition in comparison shopping markets.

Market dominance is, as such, not illegal under EU antitrust rules. However, dominant companies have a special responsibility not to abuse their powerful market position by restricting competition, either in the market where they are dominant or in separate markets.

- Today's Decision concludes that **Google is dominant in general internet search markets throughout the European Economic Area** (EEA), i.e. in all 31 EEA countries. It found Google to have been dominant in general internet search markets in all EEA countries since 2008, except in the Czech Republic where the Decision has established dominance since 2011. This assessment is based on the fact that Google's search engine has held very high market shares in all EEA countries, exceeding 90% in most. It has done so consistently since at least 2008, which is the period investigated by the Commission. There are also high barriers to entry in these markets, in part because of network effects: the more consumers use a search engine, the more attractive it becomes to advertisers. The profits generated can then be used to attract even more consumers. Similarly, the data a search engine gathers about consumers can in turn be used to improve results.
- **Google has abused this market dominance by giving its own comparison shopping service an illegal advantage**. It gave prominent placement in its search results only to its own comparison shopping service, whilst demoting rival services. It stifled competition on the merits in comparison shopping markets.

  Google introduced this practice in all 13 EEA countries where Google has rolled out its comparison shopping service, starting in January 2008 in Germany and the United Kingdom. It subsequently extended the practice to France in October 2010, Italy, the Netherlands, and Spain in May 2011, the Czech Republic in February 2013 and Austria, Belgium, Denmark, Norway, Poland and Sweden in November 2013.

The effect of Google's illegal practices

Google's illegal practices have had a significant impact on competition between Google's own comparison shopping service and rival services. They allowed Google's comparison shopping service to make significant gains in traffic at the expense of its rivals and to the detriment of European consumers.

Given Google's dominance in general internet search, its search engine is an important source of traffic. As a result of Google's illegal practices, traffic to Google's comparison shopping service increased significantly, whilst rivals have suffered very substantial losses of traffic on a lasting basis.

- Since the beginning of each abuse, Google's comparison shopping service has increased its traffic 45-fold in the United Kingdom, 35-fold in Germany, 19-fold in France, 29-fold in the Netherlands, 17-fold in Spain and 14-fold in Italy.
- Following the demotions applied by Google, traffic to rival comparison shopping services on the other hand dropped significantly. For example, the Commission found specific evidence of sudden drops of traffic to certain rival websites of 85% in the United Kingdom, up to 92% in Germany and 80% in France. These sudden drops could also not be explained by other factors. Some competitors have adapted and managed to recover some traffic but never in full.

In combination with the Commission's other findings, this shows that Google's practices have stifled competition on the merits in comparison shopping markets, depriving European consumers of genuine choice and innovation.

Evidence gathered

In reaching its Decision, the Commission has gathered and comprehensively analysed a broad range of evidence, including:

1) contemporary documents from both Google and other market players;

2) very significant quantities of real-world data including 5.2 Terabytes of actual search results from Google (around 1.7 billion search queries);

3) experiments and surveys, analysing in particular the impact of visibility in search results on consumer behaviour and click-through rates;

4) financial and traffic data which outline the commercial importance of visibility in Google's search results and the impact of being demoted; and

5) an extensive market investigation of customers and competitors in the markets concerned (the Commission addressed questionnaires to several hundred companies).

Consequences of the Decision

The Commission's fine of €2 424 495 000 takes account of the duration and gravity of the infringement. In accordance with the Commission's 2006 Guidelines on fines (see press release and

MEMO), the fine has been calculated on the basis of the value of Google's revenue from its comparison shopping service in the 13 EEA countries concerned.

The Commission Decision requires Google to stop its illegal conduct within 90 days of the Decision and refrain from any measure that has the same or an equivalent object or effect. In particular, the Decision orders Google to comply with the simple principle of giving **equal treatment** to rival comparison shopping services and its own service:

Google has to apply the same processes and methods to position and display rival comparison shopping services in Google's search results pages as it gives to its own comparison shopping service.

It is Google's sole responsibility to ensure compliance and it is for Google to explain how it intends to do so. Regardless of which option Google chooses, the Commission will monitor Google's compliance closely and Google is under an obligation to keep the Commission informed of its actions (initially within 60 days of the Decision, followed by periodic reports).

If Google fails to comply with the Commission's Decision, it would be liable for non-compliance payments of up to 5% of the average daily worldwide turnover of Alphabet, Google's parent company. The Commission would have to determine such non-compliance in a separate decision, with any payment backdated to when the non-compliance started.

Finally, Google is also liable to face civil actions for damages that can be brought before the courts of the Member States by any person or business affected by its anti-competitive behaviour. The new EU Antitrust Damages Directive makes it easier for victims of anti-competitive practices to obtain damages.

Other Google cases

The Commission has already come to the preliminary conclusion that Google has abused a dominant position in two other cases, which are still being investigated. These concern:

1) the Android operating system, where the Commission is concerned that Google has stifled choice and innovation in a range of mobile apps and services by pursuing an overall strategy on mobile devices to protect and expand its dominant position in general internet search; and

2) AdSense, where the Commission is concerned that Google has reduced choice by preventing third-party websites from sourcing search ads from Google's competitors.

The Commission also continues to examine Google's treatment in its search results of other specialised Google search services. Today's Decision is a precedent which establishes the framework for the assessment of the legality of this type of conduct. At the same time, it does not replace the need for a case-specific analysis to account for the specific characteristics of each market.

Background

See also Factsheet.

Today's Decision is addressed to Google Inc. and Alphabet Inc., Google's parent company.

Article 102 of the Treaty on the Functioning of the European Union (TFEU) and Article 54 of the EEA Agreement prohibit abuse of a dominant position. Today's Decision follows two Statements of Objections sent to Google in April 2015 and July 2016.

More information on this investigation is available on the Commission's competition website in the public case register under the case number 39740.

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Attachments

Infographic Google_en.pdf

European Commission - Fact Sheet

Antitrust: Commission fines Google €2.42 billion for abusing dominance as search engine by giving illegal advantage to own comparison shopping service - Factsheet

Brussels, 27 June 2017

The European Commission has fined Google €2.42 billion for breaching EU antitrust rules. Google has abused its market dominance as a search engine by giving an illegal advantage to another Google product, its comparison shopping service.

See also press release.

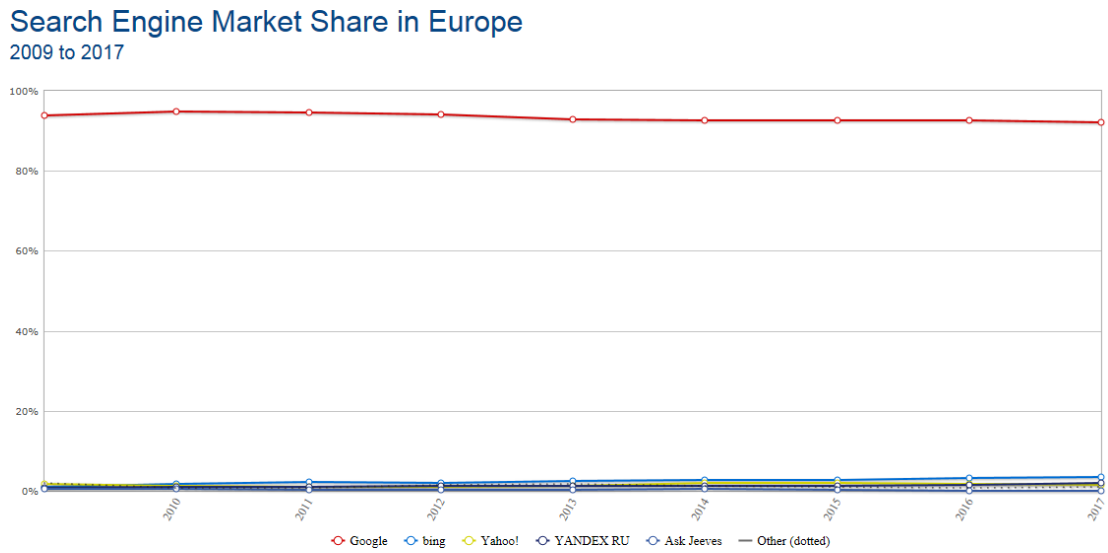
Breach of EU antitrust rules

Google's practices amount to an abuse of Google's dominant position in general internet search thereby stifling competition in comparison shopping markets.

Google's market dominance

Today's Decision concluded that **Google is dominant in each national market for general internet search throughout the European Economic Area** (EEA), i.e. in all 31 EEA countries. The Commission investigated Google's market position in general internet search since 2008, and the Decision found Google to be dominant in each country since 2008, except in the Czech Republic where the Decision found Google to have been dominant since 2011. This assessment is based on the fact that Google's search engine has held very high market shares in all EEA countries, exceeding 90% in most. It has done so consistently since at least 2008, which is the period investigated by the Commission.

There are also high barriers to entry in these markets, in part because of network effects: the more consumers use a search engine, the more attractive it becomes to advertisers. The profits generated can then be used to attract even more consumers. Similarly, the data a search engine gathers about consumers can in turn be used to improve results.



Source: StatCounter

Google's abuse of dominance

Market dominance is, as such, not illegal under EU antitrust rules. However, dominant companies have a special responsibility not to abuse their powerful market position by restricting competition, either in the market where they are dominant or in separate markets. Otherwise, there would be a risk that a company once dominant in one market (even if this resulted from competition on the merits) would be able to use this market power to cement/further expand its dominance, or leverage it into separate markets.

Google has abused its market dominance in general internet search bygiving a separate Google product (initially called " Froogle", re-named "Google Product Search" in 2008 and "Google Shopping" in 2013) an **illegal advantage** in the separate comparison shopping market.

- Google has systematically given **prominent placement** to its own comparison shopping service: Google's comparison shopping results are displayed, in a rich format, at the top of the search results, or sometimes in a reserved space on the right-hand side. They are placed above the results that Google's generic search algorithms consider most relevant. This happens whenever a consumer types a product-related query into the Google general search engine, in relation to which Google wants to show comparison shopping results. This means that Google's comparison shopping service is not subject to Google's generic search algorithms.
- On the other hand, rival comparison shopping services are subject to Google's generic search algorithms, including **demotions** (which lower a search entry's rank in Google's search results). Comparison shopping services in the EEA are prone to be demoted by at least two different algorithms, which were first applied in 2004 and 2011, respectively. Evidence shows that even the most highly ranked rival comparison shopping service appears on average only on page four of Google's search results, and others appear even further down. In practice, this means consumers very rarely see rival comparison shopping services in Google's search results.

The Commission Decision does not object to the design of Google's generic search algorithms or to demotions as such, nor to the way that Google displays or organises its search results pages (e.g. the display of a box with comparison shopping results displayed prominently in a rich, attractive format). It objects to the fact that Google has leveraged its market dominance in general internet search into a separate market, comparison shopping. Google abused its market dominance as a search engine to promote its own comparison shopping service in search results, whilst demoting those of rivals. This is not competition on the merits and is illegal under EU antitrust rules.

Thus, Google's abuse of dominance started in the respective country from the moment Google began prominently displaying its comparison shopping service, whilst demoting rival services:

- in January 2008 in Germany and the United Kingdom,
- in October 2010 in France,
- in May 2011 in Italy, the Netherlands and Spain,
- in February 2013 in the Czech Republic,
- in November 2013 in Austria, Belgium, Denmark, Norway, Poland and Sweden.

These cover all countries in the EEA in which Google currently offers its comparison shopping service.

Effect of Google's illegal practices

As explained above, Google's practices mean that its comparison shopping service appears much higher in Google's search results than rival comparison shopping services. This has had a significant impact on competition in comparison shopping markets because:

- **Appearance in Google's search results impacts on user clicks/traffic**: Real-world consumer behaviour, surveys and eye-tracking studies demonstrate that consumers generally click far more on search results at or near the top of the first search results page than on results lower down the first page, or on subsequent pages, where rival comparison shopping services were most often found after demotion.

  a) In fact, even on desktops, the ten highest-ranking generic search results on page 1 together generally receive approximately 95% of all clicks on generic search results (with the top search result receiving about 35% of all the clicks). The first result on page 2 of Google's search results receives only about 1% of all clicks. The effects on mobile devices are even more pronounced given the much smaller screen size.

  b) Furthermore, the effects cannot just be explained by the fact that the first result is more relevant because evidence also shows that moving the first result to the third rank leads to a reduction in the number of clicks by about 50%.

- **More visibility in Google's search results has increased traffic to Google's comparison shopping service, whilst demotions have decreased traffic to rival services**:

  Since the start of the abuse in each country, Google's comparison shopping service has made significant gains in traffic, whilst rival comparison shopping services have suffered a decrease in traffic from Google's search results pages on a lasting basis:

  a) For example, since the beginning of the abuse in each country, Google's comparison shopping service has increased its traffic 45-fold in the United Kingdom, 35-fold in Germany, 29-fold in the Netherlands, 17-fold in Spain and 14-fold in Italy.

  b) Traffic to rival comparison shopping websites has decreased. Whilst Google's search engine is not the only source of traffic to comparison shopping websites, due to Google's dominance as a search engine, it is an important source of traffic. The Commission found evidence of sudden drops of traffic to certain rival websites following demotions applied in Google's generic search algorithms, of 85% in the United Kingdom, 92% in Germany and 80% in France. These sudden drops could not be explained by other factors. Some competitors have adapted subsequently and managed to recover some traffic, but never fully.

This shows the impact of Google's practices both on traffic to its own comparison shopping service and to rival websites. The Commission has observed similar trends also in those countries in which the illegal practices have been implemented more recently. Its findings are further corroborated by additional information set out in the Commission Decision. This cannot be published at present without the consent of Google and other third parties, because it may contain business sensitive information.

As a result of Google's illegal practices and the distortions to competition, Google's comparison shopping service has made significant market share gains at the expense of rivals. This has deprived European consumers of the benefits of competition on the merits, namely genuine choice and innovation.

The Commission Decision concerns the effect of Google's practices on comparison shopping markets. These offer a different service to merchant platforms, such as *Amazon* and *eBay*. Comparison shopping services offer a tool for consumers to compare products and prices online and find deals from online retailers of all types. By contrast, they do not offer the possibility for products to be bought on their site, which is precisely the aim of merchant platforms. Google's own commercial behaviour reflects these differences - merchant platforms are eligible to appear in Google Shopping whereas rival comparison shopping services are not.

Nevertheless, the Commission Decision also outlines that Google's conduct would in any event have been abusive, even if comparison shopping services and merchant platforms were considered to be part of the same market: comparison shopping services would be the closest competitors in such a broader market and Google's practices have significantly distorted competition between Google's product and comparison shopping services.

Fine

The Commission's fine of €2 424 495 000 takes account of the duration and gravity of the infringement. In accordance with the Commission's 2006 Guidelines on fines (see press release and MEMO), the fine has been calculated on the basis of the value of Google's revenue from its comparison shopping service in the 13 EEA countries concerned.

Under the Decision, Google must stop its illegal practices concerning its own comparison shopping service within 90 days, and refrain from any measure that has the same or an equivalent object or effect.

In particular, Google has to respect the simple **principle of equal treatment** in its search results for its own comparison shopping product and rival comparison shopping products. Google has to apply the same processes and methods to position and display rival comparison shopping services in Google's search results pages as it gives to its own comparison shopping service.

It is Google's sole responsibility to ensure compliance and it is for Google to explain how it intends to do so. Regardless of which option Google chooses, the Commission will monitor Google's compliance closely and Google is under an obligation to keep the Commission informed of its actions (initially within 60 days of the Decision, followed by periodic reports).

Non-compliance would be the subject of a separate case where Google would have the opportunity to comment. If the Commission were to decide that Google had failed to comply with its obligations under the decision, it would be subject to a daily penalty payment of up to 5% of the average daily worldwide turnover of Alphabet, Google's parent, with any payment backdated to when the non-compliance started.

Case history and procedure

The Commission opened proceedings in this case in November 2010. This followed a number of complaints by European and US competitors that Google had breached EU antitrust rules. After an initial investigation, Google sought to address the Commission's concerns by offering legally binding commitments. Google proposed three sets of commitments (the third was submitted in February 2014). However, the feedback the Commission received from third parties showed that they were not effective to address the Commission's competition concerns in full. Google did not submit a revised proposal.

The case therefore has a specific history. Since various attempts to reach a conclusion by means of commitments failed, from November 2014, the Commission services started to update the information in the files. This led to two Statements of Objections, in April 2015 and July 2016, setting out the Commission's preliminary conclusions and a range of additional evidence.

Google's rights of defence were respected throughout the Commission's investigation – it was granted the opportunity to respond to both Statements of Objections on the basis of full access to the non-confidential Commission file as well as access to a range of confidential business and traffic data that was granted to Google's advisors in so-called "data rooms". Google also had the right to an oral hearing before the Commission services and the competition authorities of the Member States after each Statement of Objections, which it chose not to exercise.

Other cases

The Commission has already come to the preliminary conclusion that Google has abused a dominant position in two other cases, which are still being investigated. These concern:

1) the Android operating system, where the Commission is concerned that Google has stifled choice and innovation in a range of mobile apps and services by pursuing an overall strategy on mobile devices to protect and expand its dominant position in general internet search; and

2) AdSense, where the Commission is concerned that Google has reduced choice by preventing third-party websites from sourcing search ads from Google's competitors.

The Commission also continues to examine Google's treatment in its search results of other specialised Google search services. Today's Decision is a precedent which establishes the framework for the assessment of the legality of this type of conduct. At the same time, it does not replace the need for a case-specific analysis to account for the specific characteristics of each market.

MEMO/17/1785

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Antitrust: Commission sends Statement of Objections to Google on Android operating system and applications

Brussels, 20 April 2016

The European Commission has informed Google of its preliminary view that the company has, in breach of EU antitrust rules, abused its dominant position by imposing restrictions on Android device manufacturers and mobile network operators.

The Commission's preliminary view is that Google has implemented a strategy on mobile devices to preserve and strengthen its dominance in general internet search. First, the practices mean that Google Search is pre-installed and set as the default, or exclusive, search service on most Android devices sold in Europe. Second, the practices appear to close off ways for rival search engines to access the market, via competing mobile browsers and operating systems. In addition, they also seem to harm consumers by stifling competition and restricting innovation in the wider mobile space.

The Commission's concerns are outlined in a Statement of Objections addressed to Google and its parent company, Alphabet. Sending a Statement of Objections does not prejudge the outcome of the investigation.

Commissioner Margrethe Vestager, in charge of competition policy, said: "*A competitive mobile internet sector is increasingly important for consumers and businesses in Europe. Based on our investigation thus far, we believe that Google's behaviour denies consumers a wider choice of mobile apps and services and stands in the way of innovation by other players,* in breach of EU antitrust rules. These rules apply to all companies active in Europe. *Google now has the opportunity to reply to the Commission's concerns.*"

Smartphones and tablets account for more than half of global internet traffic, and are expected to account for even more in the future. About 80% of smart mobile devices in Europe and in the world run on Android, the mobile operating system developed by Google. Google licenses its Android mobile operating system to third party manufacturers of mobile devices.

The Commission opened proceedings in April 2015 concerning Google's conduct as regards the Android operating system and applications. At this stage, the Commission considers that Google is dominant in the markets for **general internet search services**, **licensable smart mobile operating systems** and **app stores for the Android mobile operating system**. Google generally holds market shares of more than 90% in each of these markets in the European Economic Area (EEA).

In today's Statement of Objections, the Commission alleges that Google has breached EU antitrust rules by:

- requiring manufacturers to **pre-install Google Search and Google's Chrome browser** and requiring them to set Google Search as default search service on their devices, as a condition to license certain Google proprietary apps;
- preventing manufacturers from selling smart mobile devices **running on competing operating systems** based on the Android open source code;
- giving **financial incentives** to manufacturers and mobile network operators on condition that they exclusively pre-install Google Search on their devices.

The Commission believes that these business practices may lead to a further consolidation of the dominant position of Google Search in general internet search services. It is also concerned that these practices affect the ability of competing mobile browsers to compete with Google Chrome, and that they hinder the development of operating systems based on the Android open source code and the opportunities they would offer for the development of new apps and services.

In the Commission's preliminary view, this conduct ultimately harms consumers because they are not given as wide a choice as possible and because it stifles innovation.

The Commission's concerns

Licensing of Google's proprietary apps

The Commission's investigation showed that it is commercially important for manufacturers of devices using the Android operating system to pre-install on those devices the Play Store, Google's app store for Android. In its contracts with manufacturers, Google has made the licensing of the Play Store on Android devices conditional on Google Search being pre-installed and set as default search service. As a result, rival search engines are not able to become the default search service on the significant majority of devices sold in the EEA. It has also reduced the incentives of manufacturers to pre-install competing search apps, as well as the incentives of consumers to download such apps.

Similarly, in its contracts with manufacturers Google also required the pre-installation of its Chrome mobile browser in return for licensing the Play Store or Google Search. Thereby, Google has also ensured that its mobile browser is pre-installed on the significant majority of devices sold in the EEA. Browsers represent an important entry point for search queries on mobile devices. Thus, by reducing manufacturers' incentives to pre-install competing browser apps and consumers' incentives to download those apps, competition in both mobile browsers and general search has been adversely affected.

Anti-fragmentation

Android is an open-source system, meaning that it can be freely used and developed by anyone to create a modified mobile operating system (a so-called "Android fork"). However, if a manufacturer wishes to pre-install Google proprietary apps, including Google Play Store and Google Search, on any of its devices, Google requires it to enter into an "Anti-Fragmentation Agreement" that commits it not to sell devices running on Android forks.

Google's conduct has had a direct impact on consumers, as it has denied them access to innovative smart mobile devices based on alternative, potentially superior, versions of the Android operating system. For example, the Commission has found evidence that Google's conduct prevented manufacturers from selling smart mobile devices based on a competing Android fork which had the potential of becoming a credible alternative to the Google Android operating system. In doing so, Google has also closed off an important way for its competitors to introduce apps and services, in particular general search services, which could be pre-installed on Android forks.

Exclusivity

Google has granted significant financial incentives to some of the largest smartphone and tablet manufacturers as well as mobile network operators on condition that they exclusively pre-install Google Search on their devices.

Google has thereby reduced the incentives of manufacturers and mobile network operators to pre-install competing search services on the devices they market. In fact, the Commission has evidence that the exclusivity condition affected whether certain device manufacturers and mobile network operators pre-installed competing search services.

Background

For further details please see Factsheet.

This investigation is distinct and separate from the Commission's ongoing formal investigation under EU antitrust rules of other aspects of Google's behaviour in the EEA, including on the favourable treatment by Google in its general search results of its own other specialised search services, and concerns with regard to copying of rivals' web content (known as 'scraping'), advertising exclusivity and undue restrictions on advertisers.

Procedural background

Article 102 Treaty on the Functioning of the European Union (TFEU) prohibits the abuse of a dominant position which may affect trade and prevent or restrict competition. The implementation of this provision is defined in the Antitrust Regulation (Council Regulation No 1/2003), which can be applied by the Commission and by the national competition authorities of EU Member States.

Today, the Commission adopted a Decision to initiate proceedings in the Google Android investigation also against Alphabet Inc., Google's parent company, which was created after proceedings had been initiated against Google. The Statement of Objections summarised above is addressed to both Google and Alphabet Inc.

A statement of objections is a formal step in Commission investigations into suspected violations of EU antitrust rules. The Commission informs the parties concerned in writing of the objections raised against them. The addressees can examine the documents in the Commission's investigation file, reply in writing and request an oral hearing to present their comments on the case before representatives of the Commission and national competition authorities. Sending a Statement of Objections does not prejudge the outcome of the investigation, as the Commission takes a final decision only after the parties have exercised their rights of defence.

There is no legal deadline for the Commission to complete antitrust inquiries into anticompetitive conduct. The duration of an antitrust investigation depends on a number of factors, including the complexity of the case, the extent to which the undertaking concerned cooperates with the Commission and the exercise of the rights of defence.

More information is available on the Commission's competition website, in the public case register under the case number 40099.

IP/16/1492

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Attachments

Google_Android_infographic EN.pdf

Photos & Videos

image EN

European Commission - Fact Sheet

Antitrust: Commission sends Statement of Objections to Google on Android operating system and applications – Factsheet

Brussels, 20 April 2016

The European Commission has informed Google of its preliminary view that the company has, in breach of EU antitrust rules, abused its dominant position by imposing restrictions on Android device manufacturers and mobile network operators.

The Commission's preliminary view is outlined in a Statement of Objections addressed to Google. It is also addressed to Alphabet, as it is standard practice for objections to also be addressed to the relevant parent company.

This Factsheet summarises key elements of the Commission's preliminary view set out in the Statement of Objections.

Sending a Statement of Objections does not prejudge the outcome of the investigation. Please also see press release.

Google's alleged market dominance

The Commission considers that Google is dominant in the markets for **general internet search services**, **licensable smart mobile operating systems** and **app stores for the Android mobile operating system**.

The Commission has considered a number of factors, including the following:

General internet search services

Google has market shares of 90% and above in most Member States.

Licensable smart mobile operating systems[1]

- Google's market shares in the EEA for licensable mobile operating systems exceed 90%. Android is used on virtually all smartphones and tablets in the lower price range, which are bought by the majority of customers.
- There are a number of barriers to entry that protect Google's position, including so-called network effects (that is, the more consumers adopt an operating system, the more developers write apps for that system).
- Finally, Android users who wish to switch to other operating systems would face significant switching costs, such as losing their apps, data and contacts.

App stores for the Android mobile operating system

- The Play Store accounts for more than 90% of apps downloaded on Android devices in the EEA.
- Manufacturers find it commercially important to pre-install the Play Store on their devices. It is pre-installed on the large majority of Android devices in the EEA and is not available for download by end users. Also, end users cannot download other app stores from the Play Store.
- Android users would generally not switch to app stores for other operating systems as they would have to purchase a new device and would face significant switching costs.

[1]Android is a licensable operating system meaning that third party handset manufacturers can use it for their devices; as opposed to operating systems exclusively used by vertically integrated developers

The Commission's concerns

Licensing of Google's proprietary apps

The Commission's investigation showed that Google obliges manufacturers, who wish to pre-install Google's app store for Android, Play Store, on their devices, to also pre-install Google Search, and set it as the default search provider on those devices. In addition, manufacturers who wish to pre-install Google's Play Store or Search, also have to pre-install Google's Chrome browser. Thereby, Google has ensured that **Google Search and Google Chrome are pre-installed on the significant majority of devices sold in the EEA**.

Smartphone and tablet manufacturers should of course be able to provide consumers with an 'out-of-box' experience by selling their devices with a bundle of apps pre-installed. The Commission seeks to ensure that **manufacturers are free to choose which apps they pre-install on their devices**. This is especially important since the Commission's analysis has shown that consumers rarely download applications that would provide the same functionality as an app that is already pre-installed (unless the pre-installed app is of particularly poor quality).

In this context, the Commission's preliminary conclusion is that by imposing the above-mentioned conditions on manufacturers, Google limits manufacturers' freedom to choose the most appropriate apps to pre-install. This strategy appears to protect and strengthen Google's dominant position in general internet search, and adversely affect competition in the market for mobile browsers. The Commission has evidence that smartphone manufacturers would wish to source at least some of the apps that they pre-install from other parties than Google.

Anti-fragmentation

Android is an open-source system, meaning that it can be freely used and developed by anyone to create a modified mobile operating system (a so-called "Android fork"). The open-source model of course does not raise competition concerns – on the contrary. The Commission's concerns relate to the conditions for use of Google's proprietary apps and services on Android devices, which are not open source.

In particular, if a manufacturer wishes to pre-install Google proprietary apps, including Google Play Store and Google Search, on any of its devices, Google requires it to enter into an "Anti-Fragmentation Agreement" that **commits it not to sell devices running on Android forks**.

EU antitrust rules allow dominant companies to put in place restrictions only when they are objectively justified. However, to date, Google has not been able to show this in relation to the restrictions in the "Anti-Fragmentation Agreements".

Google's conduct has had a direct impact on consumers, as it has denied them access to innovative smart mobile devices based on alternative, potentially superior, versions of the Android operating system. The Commission has found evidence that Google's conduct prevented manufacturers from selling smart mobile devices based on a competing Android fork which had the potential of becoming a credible alternative to the Google Android operating system. In doing so, **Google has also closed off an important way for its competitors to introduce apps and services, in particular general search services,** which could be pre-installed on Android forks.

Exclusivity

Google has granted significant financial incentives to some of the largest smartphone and tablet manufacturers as well as mobile network operators on condition that they **exclusively pre-install Google Search** on their devices.

The Commission takes issue not with financial incentives in general but with the **conditions** associated with Google's financial incentives, in particular with the condition that the financial incentive is not paid if any other search provider than Google Search is pre-installed on smart mobile devices.

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Clicks and More

Three quick items that may be of interest:

- *Google*. In early January, 2013, the U.S. Federal Trade Commission resolved its investigation of Google's search practices. While Google agreed to alter its practices in some ways, it avoided a formal FTC order.
- *Mergers*. Section 7 of the Clayton Act sets out the substantive statutory framework that applies to mergers in the United States. U.S. merger policy changed in important ways with the passage of the Hart-Scott-Rodino Act of 1976, which created a regime of pre-merger notification to the federal government of sizable merger transactions. The new act turned merger regulation away from litigation towards administrative negotiation. The Antitrust Division of the Department of Justice and the U.S. Federal Trade Commission have promulgated guidelines regarding how they evaluate mergers.