No. 15-565

IN THE
Supreme Court of the United States

APPLE INC.,

Petitioner,

v.

UNITED STATES OF AMERICA, *et al.*,

Respondents.

On Petition for a Writ of Certiorari
to the United States Court of Appeals
for the Second Circuit

BRIEF OF BSA | THE SOFTWARE ALLIANCE AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER

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BSA | The Software Alliance (BSA) is an association of the world's leading software and technology companies. On behalf of its members, BSA promotes policies that foster innovation, growth, and a competitive marketplace for commercial software and related technologies.[1]

BSA members operate in a highly dynamic and quickly evolving business environment. In this environment, vertical agreements often serve important and procompetitive purposes, facilitating innovation and keeping the United States at the forefront of software development. In making business decisions, BSA members rely on the certainty that when they enter into innovative vertical business arrangements to launch new products and services, they will have an opportunity to demonstrate the procompetitive benefits of those arrangements if challenged under the antitrust laws.

The Second Circuit's decision calls that certainty into question by suggesting that firms that engage in novel vertical business arrangements with multiple horizontal counterparties may be held *per se* liable

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[1] Pursuant to Supreme Court Rule 37.6, *amicus* affirms that no counsel for a party authored the brief in whole or in part, that no counsel or party made a monetary contribution intended to fund the preparation or submission of this brief, and that no person other than the *amicus* or their counsel made such a monetary contribution. Counsel for all parties received notice at least 10 days before the due date of *amicus*'s intention to file this brief. The parties' consents to the filing of this brief are on file with the Clerk's office.

for "facilitating" a common course of action. Because that decision directly bears on the incentive and ability of BSA members to innovate, BSA has a strong stake in the outcome of this dispute.

INTRODUCTION AND SUMMARY OF ARGUMENT

This case involves a technology company's attempt to market an innovative product by negotiating new forms of business arrangements with its suppliers. The question presented here is not whether those vertical agreements, or the horizontal agreements among competitors that they are alleged to have facilitated, might ultimately be found to violate the antitrust laws. The question is simply whether the courts should have analyzed Apple's novel vertical agreements with book publishers under the "rule of reason" test, which would have allowed for consideration of the procompetitive benefits of those vertical arrangements.

The Second Circuit held that Apple should not be given the opportunity to explain the procompetitive effects of its arrangements with the publishers because they "created a set of economic incentives" that encouraged collective action and therefore could be swept into a *per se* unlawful conspiracy. App. 51a. In so holding, the court of appeals departed from this Court's precedent, casting uncertainty over when a firm will face *per se* liability for entering into vertical arrangements. This decision, if allowed to stand, will chill beneficial innovation in the technology industry.

I. Technology companies drive innovation by creating new products that frequently rely on innovative new business strategies for their development and operation. These business strategies often depend on vertical agreements, including agreements with suppliers, developers, manufacturers, or distributors. These agreements are particularly important to BSA's innovative member companies because the agreements facilitate the launch of new products and services and make possible the complex technological infrastructure of the digital economy. These agreements promote competition and provide significant benefits for consumers.

II. The Second Circuit's decision puts at risk this commonplace use of vertical contracting terms that substantially benefit competition and enhance consumer welfare. Companies may be deterred from entering into productive vertical arrangements for fear that courts will apply the *per se* rule, regardless of their procompetitive benefits and real-world market effects. That in turn may deter companies from entering into creative business arrangements necessary for developing new products.

The Court should grant the petition and reaffirm the principle that vertical contracts—especially novel vertical arrangements in emerging technology markets—should not be condemned as *per se* violations of the Sherman Act, but rather must be analyzed under the "rule of reason" standard.

ARGUMENT

I. Vertical Agreements Are Essential to Creating Innovative Technology Products and Have Substantial Procompetitive Benefits.

Innovation, as Judge Jacobs correctly recognized, is "a hallmark and benefit of competition." App. 113a (Jacobs, J., dissenting). Innovation depends not only on developing new technologies, but also on developing and implementing new strategies for enabling and distributing those technologies. For BSA members, the freedom to experiment with new and innovative business practices is critical to their ability to develop and launch new products. These new business practices are often built around vertical agreements.

A. New Business Practices Help Drive Innovation.

In advanced economies like the United States, "[i]nnovation is the primary driver of economic growth."[2] BSA members and other companies in the

[2] David Teece, *Next-Generation Competition: New Concepts for Understanding How Innovation Shapes Competition Policy in the Digital Economy*, 9 J.L. ECON. & POL'Y 97, 97 (2012). *See also* Howard A. Shelanski, *Information, Innovation, and Competition Policy for the Internet*, 161 U. PA. L. REV. 1663, 1666 (2013) (antitrust authorities and scholars have long recognized the importance of innovation to economic growth and social welfare); Joseph P. Brodley, *The Economic Goals of Antitrust*, 62 N.Y.U. L. Rev. 1020, 1026 (1987) ("Innovation efficiency or technological progress is the single most important factor in the growth of real output in … the industrialized world.").

technology industry have been at the forefront of innovation, and have played a leading role in promoting economic growth and enhancing social welfare in the United States.

Innovation comes in many forms. Technological innovation certainly plays an important role in driving economic growth. But *business* innovation—innovations in organization, production, marketing, or distribution—has also played an important role.[3] Indeed, many of the most innovative new products combine both technological and business innovations.

The past few decades have seen an unprecedented amount of technological innovation. Consumers now have access to a wide range of products, like tablets and smartphones, that did not even exist a few years ago. Existing products also continue to improve—for example, laptop computers have become less expensive and yet more powerful than they have ever been. But technological innovation has not been limited to the development of new devices. Equally important innovations have occurred in the software that runs on these devices and in the network infrastructure that makes it possible for the devices to interact with each other.

These technological innovations have led to many business innovations. Content producers traditionally sold their music, movies, or software on

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[3] David Teece, *Next-Generation Competition: New Concepts for Understanding How Innovation Shapes Competition Policy in the Digital Economy*, 9 J.L. ECON. & POL'Y 97, 97 (2012).

discs. As high-speed internet access became more widely available, these producers developed innovative new ways to deliver their products to consumers, including by digital download or by giving purchasers access to a digital copy stored in the cloud. Companies in other sectors have developed innovative new ways to distribute their products. For example, many software developers—including BSA members like Microsoft, Autodesk, Symantec, Oracle, and Adobe—now offer a subscription model, in which consumers can pay a monthly fee to use their software, in certain circumstances. Companies like Netflix and Spotify have adopted similar subscription models for movies and music.

There are countless other examples where innovative business models introduced by high-tech companies have changed the way that consumers purchase goods and services. Companies like Expedia and Priceline introduced new models for researching and purchasing airline tickets, hotel rooms, and rental cars. And companies like eBay have created online marketplaces where individuals can sell their own goods.

B. Innovative New Business Practices That Benefit Consumers Often Depend Heavily on Vertical Agreements.

The innovative business practices discussed above have at least one thing in common: their business strategy regularly depends on vertical agreements with content providers, software developers, and even end-users of the products. As this Court has long recognized, vertical agreements often

promote competition and benefit consumers. *See, e.g.*, *Cont'l T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 54 (1977); *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, 551 U.S. 877, 891 (2007). Innovative technology companies use vertical agreements in at least three areas, and each promotes competition.

1. Vertical agreements increase the dissemination of new technologies by allowing companies to protect their intellectual property rights. The "principal output" of many technology companies is "intellectual property."[4] These companies protect and enforce their intellectual property rights through vertical licensing agreements, including technology licensing, trademark licensing, franchise licensing, and copyright licensing agreements.[5] Vertical agreements protecting intellectual property can be particularly important for software producers, both in traditional distribution channels and in new content platforms—like iTunes, Netflix, Spotify, and "App" stores—that distribute software, movies, and music.

Vertical agreements protecting intellectual property rights promote competition because they lead to the dissemination of technology and encourage innovation. As the U.S. Federal Trade Commission and Department of Justice recognize, "intellectual prop-

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[4] Richard A. Posner, *Antitrust in the New Economy*, 68 ANTITRUST L.J. 925, 926 (2001).

[5] *See*, *e.g.,* World Intellectual Property Organization, *Successful Technology Licensing*, http://www.wipo.int/sme/en/ip_business/licensing/licensing.htm.

erty licensing is generally procompetitive because it allows firms to combine intellectual property rights with other complementary factors of production such as manufacturing and production facilities and workforces."[6]

2. Vertical agreements are critical to solving the "coordination" problem that could otherwise prevent new products and services from being created in the first place. A coordination problem can arise when a company attempting to create a new platform product or service cannot attract suppliers willing to use the platform until it has users, and it cannot attract users until it has suppliers.[7] By entering into vertical agreements with suppliers, the company can then attract consumers willing to use the new platform.

The vertical agreements at issue in this case addressed this coordination problem. Apple wanted to include an iBookstore on the iPad, and that platform could be successful only if a critical mass of publishers sold books there. Companies like Netflix and

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[6] U.S. DEP'T OF JUSTICE & FED. TRADE COMM'N, ANTITRUST ENFORCEMENT AND INTELLECTUAL PROPERTY RIGHTS: PROMOTING INNOVATION AND COMPETITION 4 (2007) (citing U.S. DEP'T OF JUSTICE & FED. TRADE COMM'N, ANTITRUST GUIDELINES FOR THE LICENSING OF INTELLECTUAL PROPERTY, § 2.1 (1995), *reprinted in* 4 Trade Reg. Rep. (CCH) ¶ 13,132)).

[7] *See, e.g.*, David S. Evans, *Economics of Vertical Restraints for Multi-Sided Platforms* 8 (Coase-Sandor Institute for Law & Economics Working Paper No. 626, 2013); Robin S. Lee, *Vertical Integration and Exclusivity in Platform and Two-Sided Markets*, 103 AMERICAN ECONOMIC REVIEW, no. 7, 2013, at 2996–97.

Spotify also enter into vertical agreements with multiple content providers for the same reason: Customers will pay for their services only if they have access to a large selection of movies and music.

OpenTable provides another example. OpenTable created a platform that connects consumers with restaurants that have available reservations. For OpenTable to succeed, it needed a critical mass of both consumers and restaurants.[8] To address this coordination problem, OpenTable negotiated vertical agreements with restaurants, charging them a license fee for its software and a usage fee for each reservation, while allowing consumers to use the service for free.[9]

Vertical agreements that solve coordination problems have significant benefits for consumers. These agreements promote competition by creating products that consumers want, but which may not exist but for the vertical agreements. As economists have explained, these agreements "create[] value by coordinating the multiple groups of agents and, in particular, ensuring there are enough agents of each type to make participation worthwhile for all types."[10]

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[8] *See* David S. Evans and Richard Schmalensee, *The Antitrust Analysis of Multi-Sided Platform Businesses* 4–6 (Coase-Sandor Institute for Law & Economics Working Paper No. 623, 2012).
[9] *Id.*
[10] *Id.* at 2–3. *See generally* Daniel F. Spulber, *Solving the Circular Conundrum: Communication and Coordination in Internet Markets*, 104 Nw. U. L. Rev. 537 (2010) (platforms as interme-
(continued…)

3. Vertical agreements are often used to ensure that customers and users have a predictable experience. This is an important concern for online marketplaces like eBay, which depend heavily on vertical agreements to establish rules governing the behavior of both buyers and sellers.[11] For an online marketplace to be successful, the buyer must trust that the seller will provide the purchased good and the seller must trust that the buyer will pay for the good. The platform operator can ensure the trustworthiness of the other party by collecting and distributing the payment, and also by setting other terms and conditions (such as return policies) that the parties must follow.

The need to provide users with a predictable experience is also important for platform products like computer operating systems.[12] An operating system can be successful only if developers create programs or applications that run on the system. But a developer of an operating system often cares as much about the quality of the applications as the quantity. If the applications do not run properly or cause the

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diaries solve the coordination problem by reducing transaction costs, providing incentives, and acting as a market maker to reduce risks of participation).

[11] *See, e.g.*, eBay User Agreement, http://pages.ebay.com/help/policies/user-agreement.html.

[12] David S. Evans, *The Antitrust Analysis of Rules and Standards for Software Platforms*, 10 COMPETITION POL'Y INT'L, no. 2, Autumn 2014, at 29 (software platforms rely on "rules that require platform participants to follow certain design principles that ensure compatibility and interoperability among platform components").

system to crash, the customers will move to a competing operating system. To avoid this, operating system developers—and online platforms—enter into vertical agreements with application developers to ensure that the applications meet certain quality standards and run smoothly on the system or platform.[13]

These vertical agreements have significant procompetitive benefits.[14] For online marketplaces, the vertical agreements benefit consumers by allowing them to make purchases with greater confidence that the seller can be trusted. Through the use of vertical agreements, systems and other platforms "serve as 'enablers' of innovation by providing common interfaces through which entrepreneurs can connect their complementary products to critical masses of consumers."[15] And consumers benefit by having access

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[13] *See, e.g.*, Apple Developer Agreement, https://developer.apple.com/programs/terms/apple_developer_agreement.pdf; Twitter Developer Agreement, https://dev.twitter.com/overview/terms/agreement-and-policy; Spotify Developer Terms, https://developer.spotify.com/developer-terms-of-use.

[14] David S. Evans, *The Antitrust Analysis of Rules and Standards for Software Platforms*, 10 COMPETITION POL'Y INT'L, no. 2, Autumn 2014, at 29 (the use of governance rules by software platforms is "presumptively pro-competitive").

[15] Howard A. Shelanski, *Information, Innovation, and Competition Policy for the Internet*, 161 U. PA. L. REV. 1663, 1666 (2013); *see* Tim Wu, *Taking Innovation Seriously: Antitrust Enforcement if Innovation Mattered Most*, 78 ANTITRUST L.J., 313, 321 (2012).

to new applications that will run on a device that they have already purchased.[16]

In sum, vertical agreements play an important role in helping technology companies develop innovative new products and services. Far from being anti-competitive, these vertical agreements can promote competition and benefit consumers.

II. The Second Circuit's Ruling Will Chill Innovation by Creating Uncertainty as to the Standard Governing Antitrust Review of Vertical Arrangements.

In this case, the Government conceded that "no court has previously considered a restraint of this kind." App. 108a (Jacobs, J. dissenting). This concession should have been enough to establish that the "rule of reason" test applied. But the Second Circuit nevertheless held that Apple's arrangements with book publishers were *per se* unlawful because its vertical agreements allegedly facilitated collusion among these horizontal competitors. App. 54a–69a. The court of appeals' holding cannot be squared with this Court's decisions, which prohibit applying the *per se* rule to novel business arrangements with which the courts have little experience and recognize the potential procompetitive benefits of vertical agreements.

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[16] *See* David S. Evans, *Economics of Vertical Restraints for Multi-Sided Platforms* 8 (Coase-Sandor Institute for Law & Economics Working Paper No. 626, 2013).

In light of the harshness of the *per se* rule, this Court has repeatedly held that it should be applied with caution and only in the few cases where judicial experience demonstrates that the conduct "always or almost always tend[s] to restrict competition and decrease output." *Nw. Wholesale Stationers, Inc. v. Pac. Stationery & Printing Co.*, 472 U.S. 284, 289-90 (1985); *see also Nat'l Soc'y of Prof'l Eng'rs v. United States*, 435 U.S. 679, 692 (1978) (agreements are *per se* illegal only if their "nature and necessary effect are so plainly anticompetitive that no elaborate study of the industry is needed to establish their illegality").

Vertical agreements do not fall within this narrow class of obviously anticompetitive activities. *See Leegin*, 551 U.S. at 891. To the contrary, and as described in Part I above, these agreements have many potential procompetitive benefits, including protection of intellectual property, and development and operation of multi-sided distribution and content arrangements.

Given that the *per se* rule applies only where courts have sufficient experience with the restraint at issue, it necessarily cannot apply to novel business arrangements. *See id*. at 887 ("the *per se* rule is appropriate only after courts have had considerable experience with the type of restraint at issue"). The Court has repeatedly acknowledged this point, noting its "reluctance to adopt *per se* rules with regard to restraints imposed in the context of business relationships where the economic impact of certain prac-

tices is not immediately obvious.'" *Id.* at 887 (quoting *State Oil Co. v. Khan*, 522 U.S. 3, 10 (1997)).

If the Court's cautions about applying the *per se* rule to novel business practices and to vertical arrangements are to have any meaning, they must apply here. Apple created an innovative new product—the iPad—and was engaged in new business arrangements to facilitate its entry into the emerging eBooks market. As discussed above, vertical agreements can often be crucial for new products and business models precisely because they help ensure sufficient content to attract customers and develop necessary economies of scale. *See supra* Part I.B. The Second Circuit's decision suggests, however, that recognizing the need for this "critical mass" and encouraging its progress through vertical contracting strategies can itself trigger *per se* liability for any downstream consequences.

The Second Circuit's application of the *per se* rule in this case is of particular concern to BSA members, because technology companies often enter into creative business arrangements in developing and launching new products. BSA members rely on the Supreme Court's guidance that they will not be held to *per se* antitrust liability when engaging in novel arrangements in new technology markets, but rather will have an opportunity to explain the procompetitive justifications for such conduct if challenged. The court of appeals' ruling injects uncertainty into whether and when their vertical arrangements will be subject to the *per se* rule and will therefore deter engagement in innovative business models and

products. App. 107a (Jacobs, J. dissenting) ("uncertainty about the legality of vertical arrangements would impose vast costs on markets" (citing 11 Areeda & Hovenkamp, ¶ 1902d, at 240–41)).

BSA does not suggest that all innovative vertical arrangements should be *per se* lawful under the antitrust laws. Rather, in accordance with this Court's precedent, such arrangements should be subject to the rule of reason. That standard permits courts to consider procompetitive effects—including innovation; increased diversity, quality, and integration of products; and lower prices in the long term—alongside the alleged anticompetitive harm. Because the procompetitive and anticompetitive effects of innovative vertical business arrangements are unknown at the outset—particularly in new product markets—the rule of reason affords courts a more flexible tool to examine the actual effect on competition and avoid denouncing conduct that enhances, rather than lessens, competition.

The nature of innovative markets and the lack of empirical research to support presumptions of competitive harm in innovative industries should have given the Second Circuit particular pause before engaging in antitrust intervention.[17] "[G]iven the link between innovation and economic growth, the stakes

[17] *See* Ronald Cass, *Antitrust for High-Tech and Low: Regulation, Innovation, and Risk*, 9 J. LAW, ECON., AND POL'Y 169, 198-99 (2013) (antitrust enforcement agencies should be especially cautious when contemplating enforcement proceedings in high-technology industries).

for 'getting it right' are higher" and "[c]aution and humility are warranted" in evaluating "innovative business practices."[18] The dynamics of innovative markets are therefore particularly ill-suited to the categorical *per se* approach.

By imposing *per se* liability for novel vertical arrangements without fully evaluating the actual competitive effects in the emerging eBooks market, the Second Circuit's opinion goes against this Court's repeated cautions. If the Second Circuit's decision stands and firms are uncertain about when the *per se* rule will apply, businesses will be deterred from engaging in beneficial vertical conduct that facilitates innovation, promotes competition, and enhances consumer welfare.

CONCLUSION

The petition for a writ of certiorari should be granted and the judgment of the court of appeals should be reversed.

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[18] Joshua D. Wright, "Antitrust, Economics, and Innovation in the Obama Administration," *GCP: The Antitrust Chronicle* (November 2009); *see also* David. S. Evans, *The Antitrust Analysis of Rules and Standards for Software Platforms*, 10 COMPETITION POL'Y INT'L, no. 2, Autumn 2014, at 29 ("Competition policy should therefore exercise caution in condemning the application of governance rules for software platforms.").

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