AN INTRODUCTION TO COMPETITION CONCERNS IN THE GOOGLE BOOKS SETTLEMENT

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Abstract

Google started its Google Books project in 2004 with the intent to create a digital library of the world's books.[1] *There has not been such a grand plan since students of Aristotle began to gather the world's knowledge in the Library of Alexandria some 24 centuries ago. The world's knowledge has changed. And so has its political economy. Twenty-first century public policy questions have been interjected to delay and reshape Google's project, questions that did not concern the royal sponsors of the ancient Library. This review takes up questions of competition policy raised in the United States, the corporate site for Google's virtual Library of Alexandria.*

After presenting the factual background to the Google Books project and the procedural history of the current class-action lawsuit, we examine two clusters of competition issues concerning the Google Books project:[2] *First, whether a class action settlement in litigation between private parties is an appropriate vehicle for making public policy. Second, whether Google's actions are on balance anticompetitive under U.S. antitrust laws. Antitrust concerns will be given the lion's share of attention.*

Keywords:

Google Books project, settlement, litigation, antitrust laws

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[1] This review appears in MERCATO, CONCORRENZA, REGOLE (Milan 2010) (Ital. trans., Andrea Giannaccari). *See* About Google Books, http://books.google.com/googlebooks/history.html (last visited November 5, 2009).

[2] We do not discuss a third competition issue – the fair use defense to copyright infringement.

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1. Factual background and class-action suit history

Like the Ptolemaic Dynasty that sponsored the ancient Alexandria Library, Google dominates its domain. With over 70 percent of the United States search market, Google's dominance amounts to monopoly power under the antitrust laws. Google's revenues exceeded $21 billion last year, and through its search results and sponsored links it controls indirectly hundreds of billions of dollars of other companies' revenues.

Soon after its inception, the Google Books project provoked a lawsuit claiming large-scale copyright infringement.[1] In late 2005, the Author's Guild of America and the Association of American Publishers filed a class action lawsuit against Google in the Southern District of New York.[2] Google raised a fair use defense in answer, arguing that scanning and displaying portions, or snippets, of a book are permitted infringements of the owners' copyrights.[3]

On October 28, 2008, the parties reached a proposed settlement agreement.[4] By the time the proposed settlement was submitted to the court, Google had scanned upwards of seven million books.[5] Here is how the project works: Once a book is scanned, it is added to Google's database and categorized depending on the book's copyright status.[6] "If the text is no longer protected by copyright, the entire book is available for online viewing or download. However, if a book is still under copyright, only 'snippets,' or three-four line text sections, are available unless the rights holder has opted out completely or consented to a broader display, such as certain pages or chapters."[7] Google's bold strategy was to scan now and negotiate later.

The proposed settlement agreement ("proposed Settlement") essentially grants Google a non-exclusive license to all books listed in the Books Rights Registry ("Registry").[8]. The Registry is a catalogue listing the copyrighted books owned by everyone in the plaintiff class but those who choose to opt out of the Proposed Settlement. And most importantly, the Proposed Settlement purports to grant Google the right to continue scanning and digitizing copyrighted works to build a digital corpus of the world's books. Google will be authorized to

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[1] Fraser, *supra* note 5.

[2]McGraw-Hill Co. v. Google Inc., No. 05 CV 8881-JES (S.D.N.Y.); Authors Guild of America v. Google Inc., No. 05 CV 8136-JES (S.D.N.Y.). The cases were consolidated.

[3] *See* Fraser, *supra* note 5.

[4] Settlement Agreement, The Author's Guild, et. al. v. Google Inc., No. 05-CV-8136 (S.D.N.Y. Oct. 28, 2008) [hereinafter "settlement agreement"].

[5] *See* New chapter for Google Book Search (Oct. 28, 2008), http://googleblog.blogspot.com/2008/10/new-chapter-for-google-book-search.html (last visited November 5, 2009).

[6] *See* Eric Fraser article, at 4.

[7] Neal R. Stoll & Shepard Goldfein, *Google, Antitrust and 'Change We Need' – But When?*, 242 N.Y.L.J. 3(col. 1) (Oct. 20, 2009).

[8] *See* Stoll & Goldfein, *supra* note 6.

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display portions of those copyrighted works in response to user searches and queries as well as make non-display uses such as drawing upon the digitized works to improve its core search algorithms.[1] Google will also be permitted to exploit the digital corpus in new revenue streams through the creation and maintenance of an Institutional Subscription Database for licensed use by entities such as university libraries, through the sale of digital copies of individual copyrighted works, and through the placement of advertisements on the Google Books web pages.[2]

Google will pay 63 percent of all revenues earned by such uses into a Settlement Class Fund ("Fund"), administered by the Registry, for the rights holders of the works.[3] Google is required to pay a minimum of $45 million into the Fund for those rights holders whose works will have been digitized prior to the opt-out deadline.[4]

On September 18, 2009 the Antitrust Division of the Department of Justice formally objected to the proposed Settlement, particularly provisions that raised questions of price-fixing and other cartel-like behavior under Sherman Act Section 1. In light of the concerns raised by the Antitrust Division, particularly those related to antitrust law, the parties began to consider amendments. Then on February 4, 2010, the Antitrust Division filed a second Statement of Interest with the court raising additional concerns, particularly about the proper bounds of class action settlements and the resulting market entry barriers.[5] The Antitrust Division as well as interested third parties have filed numerous briefs with the court and published commentaries across the Internet.[6] We will discuss briefly the class action question before proceeding to the antitrust issues.

2. Is a class action settlement between private litigants an appropriate vehicle for making public policy?

Commentators quickly raised questions about whether a settlement between private parties is an appropriate vehicle for setting conditions in a far-reaching matter of public importance. The Antitrust Division joined the chorus of critics in its second Statement of Interest:

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[1] *See* Randal C. Picker, *The Google Book Search Settlement: A New Orphan-Works Monopoly?* 20 (University of Chicago Law School John M. Olin Law & Economics Working Paper No. 462 (2d series)), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1387582.
[2] *See* Stoll & Goldfein, *supra* note 6; Settlement Agreement, *supra* note 10, at §4.
[3] Settlement Agreement, *supra* note 10, at §2.1(a).
[4] Settlement Agreement, *supra* note 10, at §2.1(b).
[5] The Author's Guild, et. al. v. Google, Inc., No. 05-CV-8136 (S.D.N.Y. Oct. 28, 2008; February 4, 2010).
[6] For a full listing of court documents, see http://thepublicindex.org/documents/amended_settlement.

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Although the United States believes the parties have approached this effort in good faith and the amended settlement agreement is more circumscribed in its sweep than the original proposed settlement, the amended settlement agreement suffers from the same core problem as the original agreement: it is an attempt to use the class action mechanism to implement forward-looking business arrangements that go far beyond the dispute before the court in this litigation.[1]

There were three major objections reflecting the concern that parts of the settlement "exceed the proper bounds of a class action settlement." First, that the plaintiffs do not have the authority to grant Google the copyrights belonging to holders not included in the class of plaintiffs. Second, that the representatives of the class do not have the same interests as some of the copyright holders whose rights might be affected by the settlement. And third, that there is no evidence that all potential rights holders have been given adequate notice of the settlement. Each of these objections reflects potentially anti-competitive effects.

To address the anticompetitive effects, the Antitrust Division made a series of recommendations for revising the settlement. They include the following: First, that the court require copyright holders to opt *in* to the terms of the proposed Settlement rather than opt *out*, as the current settlement provides. With the current provision, Google automatically gets copyright to all books unless the copyright holder objects. The criticism of an opt in provision is the likelihood of large search costs for Google. Second, that the settlement apply only to "U.S. works." Broader application raises numerous questions of fairness, anti-competitive effects, international comity, and enforceability. Third, that current provisions regarding so-called "orphan works"[2] be changed to require that Google meet defined guidelines to minimize the number of books that fall into the category of orphan works, including standards for what constitutes "diligent search" for authors and periodic reassessment of orphan work status. Fourth, that procedures be developed to allow late comers to enter the market for orphan works. The overarching competition concern here is that the settlement gives Google an economic monopoly over orphan works, which in European terms could call for treating Google as an essential facility. Of course a wide range of abuses of its dominant position would be possible, from setting monopoly prices, bundling products, or integrating services to raising barriers to entry.

[1] Department of Justice, Press Release, 4 February 2010, quoting second Statement of Interest.
[2] Orphan works defined as books whose copyright holders cannot be located.

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3. Does the settlement permit Google to act in ways considered anticompetitive under the antitrust laws?

For the most part, our discussion will focus on the concerns raised in the Antitrust Division's two Statements of Interest, with some attention to comments made by others.

The Antitrust Division's first Statement of Interest emphasized concerns about legality under Sherman Act 1, in particular that the Proposed Settlement bears an uncomfortable resemblance to a cartel agreement giving book publishers the power to restrict price competition.[1]

The Antitrust Division asserts that the Proposed Settlement appears to restrict price competition among authors and publishers in at least three respects: "(1) the creation of an industry-wide revenue-sharing formula at the wholesale level applicable to all works; (2) the setting of default prices and the effective prohibition on discounting by Google at the retail level; and (3) the control of prices for orphan books by known publishers and authors with whose books the orphan books likely compete."[2]

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[1] Statement of Interest of the United States of America Regarding Proposed Class Settlement, The Author's Guild, et. al. v. Google Inc., No. 05-CV-8136 (S.D.N.Y. Sept. 18, 2009) [hereinafter 'Statement of Interest']. The statement also expressed competition concerns that the proposed settlement grants Google de facto exclusive rights for the digital distribution of orphan work books, which may effectively preclude others from "competing with Google in the sale of digital library products and other derivative products to come." This is discussed below in light of the second Statement's more recent views. Regarding these and other issues, *see also*, Objection of Amazon.com, Inc., to Proposed Settlement, The Author's Guild, et. al. v. Google Inc., No. 05-CV-8136 (S.D.N.Y. Sept. 18, 2009); Brief of Amicus Curiae Consumer Watchdog In Opposition to the Proposed Settlement Agreement, The Author's Guild, et. al. v. Google Inc., No. 05-CV-8136 (S.D.N.Y. Sept. 18, 2009); Objection of Yahoo! Inc. to Final Approval of the Proposed Class Action Settlement, The Author's Guild, et. al. v. Google Inc., No. 05-CV-8136 (S.D.N.Y. Sept. 18, 2009); Brief of Amicus Curiae Public Knowledge in Opposition to the Proposed Settlement, The Author's Guild, et. al. v. Google Inc., No. 05-CV-8136 (S.D.N.Y. Sept. 18, 2009).

[2] *See* Statement of Interest, *supra* note 17. The jurisprudence can be summarized as follows: Section 1 of the Sherman Act declares illegal "[e]very contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations." 15 U.S.C. §1 (2009); Nat'l Soc'y of Prof'l Eng'rs v. United States, 435 U.S. 679, 687-88 (1978). The Supreme Court has held that certain restraints "are so 'plainly anticompetitive,' and so often 'lack . . . any redeeming virtue,' that they are conclusively presumed illegal without further examination…." Broadcast Music, Inc. v. Columbia Broadcasting System, Inc., 441 U.S. 1, 8 (1979) (citing National Society of Professional Engineers v. United States, 435 U.S. 679, 692 (1978); Continental T. V., Inc. v. GTE Sylvania Inc., 433 U.S. 36, 50 (1977); Northern Pac. R. Co. v. United States, 356 U.S. 1, 5 (1958)). However, every agreement concerning trade can be said to restrain and thus, fall under *per se* illegality. Therefore, the Court has crafted the rule of reason analysis, where "[t]he true test of legality 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."

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Under the Proposed Settlement, Google will offer institutional subscriptions to the digital corpus for purchase at the wholesale level.[1] Currently, publishers and authors compete on the prices to wholesalers and distributors.[2] The Proposed Settlement seemingly eliminates such competition and allows the Registry and Google to license the entire digital corpus. Using a specified set of parameters, Google will set the price of access to the entire corpus[3] and pay 63 percent of the revenues to the Registry for distribution to rights holders.[4] While such provisions are typically treated as illegal *per se*,[5] there are narrow exceptions for price-fixing that a court may find applicable to the Proposed Settlement. In *Broadcast Music, Inc. v. CBS*, the Court held that a blanket copyright license covering all musical compositions was not illegal *per se*, and instead analyzed the case under the rule of reason.[6] The *BMI* court ultimately concluded that the blanket license had procompetitive effects, in that it produced cost efficiencies in selling, monitoring, and enforcing rights, and that blanket licenses created a new "product."[7] Similarly, in *NCAA v. Board of Regents*, the Court again rejected a *per se* analysis and applied the rule of reason.[8] This time, however, the Court held the agreement was illegal because the price and output restrictions were not justified by procompetitive efficiencies.[9]

Here, the Proposed Settlement appears quite similar to the blanket license in *BMI*. It is likely to produce many of the same cost efficiencies that persuaded the *BMI* Court. It also creates a new "product," without ousting the old one. However, in its view of the *per se* rule, the Antitrust Division distinguished the Proposed Settlement from *BMI* in several ways.[10] To begin, regardless of the new "product" Google might offer, it "will also act as a joint sales agent, offering each right holder's book for individual sale."[11] This is

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Under the rule of reason analysis, courts must consider the "facts peculiar to the business, the history of the restraint, and the reasons why it was imposed," and courts must balance the procompetitive justifications for the restraint against its anticompetitive effects. *Nat'l Soc'y*, 435 U.S. at 692; *see also* Board of Trade v. United States, 246 U.S. 231, 238 (1918).

[1] Settlement Agreement, *supra* note 10, at §4.1.

[2] *See* Statement of Interest, *supra* note 17.

[3] Settlement Agreement, *supra* note 10, at §4.1(a)(ii).

[4] *Id.* at §§4.5, 2.1(a).

[5] These provisions, like the horizontal agreement among competitors to eliminate credit in wholesale agreements in *Catalano, Inc. v. Target Sales, Inc.*, 446 U.S. 643, 646-50 (1980). or the maximum fee schedule agreed upon by doctors for reimbursement for health services provided to policy holders of certain insurance plans in *Arizona v. Maricopa County Medical Society*, 457 U.S. 332, 349 (1982), constitute price-fixing and a likely *per se* violation of section 1 of the Sherman Act.

[6] 441 U.S. 1, at 24-25 (1979).

[7] *Id.* at 21-23.

[8] 468 U.S. 85 (1984).

[9] *Id.* at 92-96.

[10] *See* Statement of Interest, *supra* note 17.

[11] *Id.*

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significant in light of the proposed Settlement provision that allows publishers and authors to agree with Google on prices concertedly rather than bilaterally, in consequence reducing competition among rights holders for their shares of the blanket license revenues.[1] Finally, the proposed Settlement lacks safeguards that were present in *BMI*, namely the consent decree and continued judicial oversight, leaving Google and the Registry unfettered power to set the price of the institutional subscriptions.[2] Whether these provisions could pass muster under such a rule of reason analysis is questionable at best.

At the retail level, the proposed Settlement allows Google to offer books for purchase by consumers.[3] Rights holders may select one of two pricing options for such purchases – set their own prices or permit the prices to be set by a "Pricing Algorithm" to be developed by Google – with the pricing algorithm as the default.[4] Courts have found the use of a common formula and other joint price-setting mechanisms for competing goods illegal *per se*.[5] According to the Antitrust Division, "[t]his feature of the Proposed Settlement warrants particular scrutiny."[6]

On the other hand, the Proposed Settlement does not explicitly discuss a price floor. Nor does the 63 percent royalty rate automatically amount to a price floor.[7] One commentator believes "[t]he Antitrust Division has confused a provision for additional revenue as a price-setting mechanism."[8] The Proposed Settlement states "Google may change the price of an individual Book over time" and the "distribution of Books ... among the Pricing Bins may change over time."[9] But individual authors and publishers do retain the right to set the price for their own works.[10] For these rights holders, competition on price will continue outside of the pricing algorithm. The incentive for individual rights holders to lower prices to capture sales remains, while the proposed Settlement envisions that Google will design the pricing algorithm "to find the optimal such price for each Book and, accordingly, to maximize revenue for each rights holder."[11]

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[1] *Id.*
[2] *Id.*
[3] Settlement Agreement, *supra* note 10, at §4.2.
[4] *Id.* §4.2(b).
[5] *See Catalano*, 446 U.S. at 647-48 ("Indeed, a horizontal agreement among competitors to use a specific method of quoting prices may be unlawful."). United States v. Socony-Vacuum Oil Co., 310 U.S. 150, 222-23 (1940). "Under the Sherman Act a combination formed for the purpose and with the effect of raising, depressing, fixing, pegging, or stabilizing the price of a commodity in interstate or foreign commerce is illegal per se." *Id.* at 223.
[6] *See* Statement of Interest, *supra* note 17.
[7] *See* Stoll & Goldfein, *supra* note 6.
[8] *Id.*
[9] Settlement Agreement, *supra* note 10, at §4.2(c).
[10] *Id.* at §4.2(b)(i)(1).
[11] *Id.* at §4.2(b)(i)(2).

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Finally, Google's exclusive access to orphan works[1] places control over the pricing of orphan works in the hands of the Registry, which is also the proxy for known authors and publishers. The Registry's power to set prices for orphan work books serves the interests of the known authors and, in consequence, presents a conflict of interest that could lead to pricing decisions favoring the known authors.[2] This provision of the proposed settlement may amount to a price fixing cartel in a violation of section 1 of the Sherman Act.[3]

The parties returned to the negotiating table to address the questions raised about competition impact as well as fair treatment of all affected copyright holders. On November 13, 2009, the parties filed an amended Settlement Agreement with the court.[4] On February 4, 2010, the Antitrust Division filed its second Statement of Interest after review of the amended settlement.

The second Statement of Interest raised concerns about the class lawsuit as a vehicle for making public policy, reiterated concerns about the pricing provisions, and looked more closely into potential abuses by Google of the dominant position created by the proposed Settlement. We turn now to concerns expressed about Sherman Act Section 2 monopolization.

The Antitrust Division was particularly concerned that the proposed Settlement would enable Google "to be the only competitor in the digital marketplace with the rights to distribute and otherwise exploit a vast array of works in multiple formats." Moreover, the Statement of Interest observed the folly of attempts by Google's competitors to obtain comparable rights independently.

For example, Amazon—Google's likely chief rival digital book distributor were the [proposed Settlement] to be approved—began scanning copyright-protected books in 2002, after first securing permission of the works' rightsholder(s). To date, Amazon has amassed a library of approximately three million digital titles. … This impressive number pales in comparison to the tens of millions of books Google has scanned or is poised to scan if the [proposed Settlement] is approved. The suggestion that a competitor should follow Google's lead

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[1] Orphan Works are defined as "copyrighted works — books, music, records, films, etc — whose owner cannot be located." Public Knowledge, Orphan Works, http://www.publicknowledge.org/issues/ow (last visited Nov. 16, 2009). One commentator believes that no competitor will ever be able to obtain the necessary permissions to make competing uses of these orphan works and therefore, that Google is granted a legally enforced monopoly on the commercial exploitation of the orphan works. *See* Brief of Amicus Curiae Institute for Information Law & Policy, New York Law School, The Author's Guild, et. al. v. Google Inc., No. 05-CV-8136 (S.D.N.Y. Sept. 18, 2009).

[2] *See* Statement of Interest, *supra* note 17. Moreover, in what also might be considered a Sherman Act Section 2 concern about abuse of its dominant position, such exclusive control gives Google and the Registry the ability to charge supra-competitive prices for orphan work books.

[3] 15 U.S.C. §1 (2009).

[4] Brad Stone & Miguel Helft, *Google and Partners Revise Terms of Digital Book Deal*, N.Y. TIMES, Nov. 14, 2009, at B2.

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by copying books en masse without permission in the hope of prompting a class action suit to be settled on terms comparable to the [proposed Settlement] is poor public policy and not something the antitrust laws require a competitor to do.[1]

And so the Antitrust Division concluded with a call for further amendment to "provid[e] a mechanism by which Google's competitors can gain comparable access." But none was proposed, with the implication that the parties should return to the bargaining table to develop a mechanism.

Of the numerous comments and proposals made by *amici curiae* and others, three are worth mention here. First, there is the comment of Professor Einer Elhauge of Harvard Law School. Entitled "Framing the Issues in the Google Books Settlement,"[2] Elhauge applies neo-classical price theory to the proposed Settlement and concludes that it is undoubtedly pro-competitive because it improves consumer welfare by lowering price and increasing output over a but-for world without the proposed Settlement. Certainly that is a correct statement of its likely pro-competitive effects, at least in the short-run. Indeed, almost everyone, including the Antitrust Division, agrees. But that is not the question for the court and for those commenting on the proposed Settlement. The proper question is whether it can be improved to serve the public interest as well as the private interests of the parties. What makes Elhauge's analysis virtually irrelevant, given that no one disagrees with the implications of a static consumer welfare analysis, is Elhauge's framing of the question. Though he purports to be motivated by the "debatable spins and arid formalisms" of those criticizing the proposed Settlement, he makes his own framing error. The error is in treating a *proposed* Settlement as a *fait accompli* and therefore to be compared only to a but-for world when the very purpose of opening such settlement agreements to public comment is to improve them. In this light, the antitrust issues are properly framed by comparing the proposed Settlement provisions to less restrictive alternatives that emerge from the public discussion.

In sharp contrast, a comment by Professor Pamela Samuelson of UC Berkeley Law School discusses a number of relevant concerns, including several raised by the Antitrust Division. What Samuelson[3] adds to the debate is a focus on Google's ability to integrate its Google Book Search with other products and services in the market for institutional subscriptions to universities, libraries, and other institutions involved in information or education. Given Google's five-year head start, potential entrants would recognize their comparably incomplete databases of books and, in consequence, their entry would be deterred.[4]

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[1] Second Statement of Interest at p. 21.

[2] Available at www.competitionpolicyinternational.com.

[3] Available at http://www.huffingtonpost.com/pamela-samuelson/why-is-the-antitrust-divi_b_258997.html.

[4] This is not unlike the applications barrier to entry at work in the U.S. *Microsoft* case.

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Together with numerous existing licenses for institutional subscriptions, Google would have a double head start that could generate network effects and further deter entry. Samuelson leaves to another day recommendations to address the danger that Google could dominate the market for institutional subscription licenses.

Finally, there is a recent OpEd piece in the *New York Times* that assailed Google's conduct as the dominant search engine. Though there was no mention of the Google Book project, the comment nonetheless raises an important competition concern, one that gives some insight into the strategic conduct that Google might deploy in its exploitation of the Google Book project. Written by the founder of an Internet technology firm, the article called for "search neutrality."[1] Here is how he put Google's abuse of dominance in the search engine market:

Google exploits its control . . . through preferential placement. With the introduction in 2007 of what it calls "universal search," Google began promoting its own services at or near the top of its search results, bypassing the algorithms it uses to rank the services of others. Google now favors its own price-comparison results for product queries, its own map results for geographic queries, its own news results for topical queries, and its own You Tube results for video queries.

Combined with Professor Samuelson's concern about the potential network effects of head starts in data base and customer base sizes, Google's conduct in the search engine market amounts to what the OpEd author called "a virtually unassailable competitive advantage" – not only in the search engine market but in markets for digitized books and complementary products and services.

The Google Book project presents an enormous opportunity for public good by digitizing and making available such a large number of the world's books. No one doubts that. But the proposed Settlement raises serious competition concerns about coordinated horizontal pricing among authors and publishers, with Google as the facilitator,[2] and more broadly about the potential effects of giving Google the dominant position in an array of emerging markets for digitized books together with complementary products and services. Did the Paris County Court get it right when it recently ruled that the unauthorized scanning of works and posting of excerpts online constituted infringement under French law, and refused to apply the fair use doctrine as set forth under U.S. law? Or does the matter involve public policy questions too important to be left to private litigation, whether in New York or Paris, matters better left to national legislatures or perhaps the World Intellectual Property Organization?[3]

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[1] Adam Raff, "Search, but You May Not Find," NEW YORK TIMES, p.A27, December 28, 2009.

[2] *See* Randal C. Picker, *Assessing Competition Issues in the Amended Google Book Search Settlement*, 5 (University of Chicago Law School John M. Olin Law & Economics Working Paper No. 499 (2d series)), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1507172.

[3] Tribunal de grande instance [T.G.I.][ordinary court of original jurisdiction], Paris, Dec. 18, 2009, Editions du Seuil v. Google Inc., No. RG 09/00540, *available at* http://www.juriscom.net/documents/tgiparis20091218.pdf.

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