AN ANTITRUST ANALYSIS OF THE GOOGLE BOOK SEARCH SETTLEMENT

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ABSTRACT

The Google Book Search settlement has raised intense debates on its far-reaching effects on copyright and digital distribution of books. This paper focuses on three issues that raise antitrust and competition concerns. First, the Books Rights Registry created by the settlement is not a cartel of the authors. Due to an author’s ability to opt out from the settlement or to set an independent price for the books, the Registry cannot act as a cartel because it lacks a price control function. Second, Google does not violate the section 2 of the Sherman Act by monopolizing the digital books. The settlement is not an exclusive agreement to bar possible competitors such as Microsoft or Amazon from entering the market and competing with Google. Neither do the orphan works with little commercial value give Google any insurmountable advantages on competition. Third, Google’s default pricing mechanism does not constitute price-fixing under section 1 of the Sherman Act. Google is authorized by authors or other rights-holders to set the price of online access to consumers. The authors’ right to set an independent price and the potential competition from Microsoft and Amazon, would negate any reasonable economic incentives for Google to charge a high (that is, supra-competitive) price. In brief, there is little difference between the prices set by Google’s default pricing algorithm and what would be set by direct competition among rights-holders.

Introduction .................................................................................................................................. 2
I. Is the Books Rights Registry a Book Cartel? ........................................................................... 3
II. Does Google Monopolize the Digital Books?...................................................................... 4
   A. The Relevant Market........................................................................................................... 4
   B. Monopoly Power and Exclusionary Agreement .............................................................. 6
   C. Orphan Books.................................................................................................................. 11
   D. Refusal to Deal and Price Discrimination ..................................................................... 13
III. Is Google’s Default Pricing a Price-Fixing?................................................................. 14
Conclusion .................................................................................................................................. 18
INTRODUCTION

On October 28, 2008, Google entered into a settlement agreement with the Authors Guild and the Association of American Publishers who sued Google in 2005 citing "massive copyright infringement" related to the Google Books Library Project. Under the settlement, Google will be authorized to scan and sale digital versions of each book that has not been opted out to set up a digital library of the world’s books. In return, authors and copyright holders will receive 63 percent of all advertising and e-commerce revenues associated with their works.

Although the agreement has not yet been approved, commentators have expressed widespread agreement that the Google Book Search project (“GBS”) is a good idea. For example, Professor James Grimmelmann states that “the project will be immensely good for society, and the proposed deal is a fair one for Google, for authors, and for publishers.” Through worldwide accessibility and indexing that enables searching, it is foreseeable that Google’s Book Search program will aid in the spreading and development of knowledge.

However, the breadth of the settlement has stirred up significant legal concerns, some of which are antitrust concerns. Various scholars and organizations have advocated modification or rejection of the settlement, based in part on concerns regarding Google’s claimed ability to exercise market power. Opponents generally argue that the settlement would give Google an unfair advantage over competitors in the book search and book distribution market. More specifically, they claim that it abuses class action procedure to create an exclusive joint venture between Google and the copyright holders, strengthening Google’s dominance in search and creating a cartel for the sale of digitalized books. In contrast, supporters generally argue that the new services or works made available through the settlement would have positive effects on the market for books, digital books, and scholarly access to books.

The Google Books settlement goes much farther than a typical class action settlement by achieving a kind of collective license from the copyright holders. Nevertheless, this creative strategy does not lead to cartel pricing (a violation of the section 1 of the Sherman Act) or monopolization (a section 2 violation). Thus this paper addresses concerns about the settlement raised by Professors Randal Picker, James Grimmelmann, and Pamela Samuelson. Specifically, Part I considers whether the centralized decision-making would make the Books Rights Registry a cartel of the authors; Part II discusses whether Google attempts to

1 See Authors Guild of America v. Google Inc., No. 05 CV 8136-JES (S.D.N.Y., 2005).
monopolize the digital books market by excluding competition through erecting high entry barriers, e.g., entering into an exclusive agreement with the authors and increasing access to orphan books; and Part III analyzes the price-fixing issue raised by Google’s default pricing (also called the settlement-controlled price).

I. IS THE BOOKS RIGHTS REGISTRY A BOOK CARTEL?

A cartel is a combination of producers or sellers that join together to control a product's production or price.\(^6\) Amazon.com, a competitor of Google in the digital books market, filed an amicus brief claiming that the Books Rights Registry (“the Registry”) created by the settlement is a cartel of authors and publishers. Amazon further argued that due to the absence of restrictions on the Registry’s action, the Registry has a dangerous potential to raise book prices and reduce output to the detriment of consumers and new authors or publishers who would compete with the cartel member.\(^7\) However, a detailed review of the settlement’s Article VI “Establishment and Charter of Registry,” undermines Amazon’s cartel conclusion.

First, working as a bridge between digital book suppliers and book rights-holders, the Registry was created mainly for a necessary administrative purpose under sections 6.1 and 6.2 of the settlement. Its functions include maintaining a database of copyrights ownership, assisting ownership disputes, processing payments, auditing Google, and so on. Such administrative functions obviously cannot achieve a cartel organization’s purpose of price control.

Second, besides these administrative functions, the Registry is a centralized entity with the authority to negotiate on behalf of all registered book copyright owners. Specifically, it has broad discretion to work out an equitable formula for dividing revenues among publishers and authors.\(^8\) It can negotiate the terms of new revenue models (e.g., print-on-demand, PDF downloads, and course packs).\(^9\) Professor Grimmelmann says that these characteristics mean that the Registry “walks and quacks like a cartel.”\(^10\)

However, a further inquiry into the negotiation contents weakens Grimmelmann’s concerns. What does a revenues dividing formula mean? In and of itself, a revenue allocation does not control how much a book should cost. Nor does it control how many “copies” of a book will be accessed. What it addresses is how to attribute the revenues from sale among authors and publishers. That is an issue about how the authors and publishers handle their internal financial relationship. Why should this allocation be troubling? Isn’t it a common and necessary business practice between authors and publishers? The same analysis applies to the new revenue models. Like the ASCAP/BMI,\(^11\) the Registry is a non-profit organization. It merely represents the copyrights holders to license the copyrights collectively to any potential

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\(^6\) See Black’s Law Dictionary, 8th ed. “cartel”.
\(^8\) The Revised Settlement attachment C 1.1 (a)
\(^9\) The Revised Settlement 4.7, see also James Grimmelmann, How to Fix the Google Book Search Settlement, 12 INTERNET L. No. 10, 10, 13.
\(^10\) Id.
book sellers (e.g., Google, Amazon and Yahoo). The purpose is to promote the cooperation between authors and book sellers, easing the difficulties and the transaction cost of individual negotiation. However, unlike ASCAP, the registry does not sell any books directly or indirectly to anyone. The Registry therefore does not have a reason like ASCAP to live under antitrust consent decrees.

The joint Justice Department / FTC Horizontal Merger Guidelines provide further support for this analysis. The Guidelines identify three necessary components to form and maintain a cartel: i) reaching an agreement on terms, ii) the ability to detect cheating, and iii), successful punishment of cheating. 12 Although there is an agreement between the rights-holders, neither of the latter two factors are present here. First, it is hard to detect a price cut because the number of books is so immense. The smaller the number of firms in the industry, the easier for the members of the cartel to monitor the behavior of other members and vice versa. Given that detecting a price cut becomes harder as the number of firms increases, the bigger are the gains from price cutting. So, the gains would be a great incentive for each author or publisher to cut the price. Secondly, because books are highly differentiated products sold by numerous book publishers, changes in quantity sold by a member may be due to changes in consumer preferences or demand.13 More importantly, the Registry does not mean to detect or punish any price-cut for any of its members at all. Under the agreement, each copyright holder can choose its preferred price for Consumer Purchase or just opt out from the settlement.14 These facts severely limit the possibility that a cartel could form and be stable.

Therefore, although the Registry is a combination of the book rights-holders, it does not constitute a cartel due to the lack of product/price control function. Without the price control function, Amazon’s concern on the Registry’s potential to raise book prices and reduce output is unfounded.

II. DOES GOOGLE MONOPOLIZE THE DIGITAL BOOKS?

A. The Relevant Market

The market is a key measurement unit for a competitor’s market power. A relevant market defines the market in which one or more goods compete. It has two components: the product market and the geographic market. Because of its nationwide operation, the relevant geographic market for the GBS project includes the entire United States. However, it is not so easy to define the relevant product market for the GBS project. By creating a digital database of books available worldwide and combining it with its powerful search engine technology, Google creates a new platform for accessing books. In brief, the new product market is a combination of online-books and book-search markets. Are there any products that could constitute substitutes providing a significant competitive constraint on Google’s new product?

From the supply-side, several other firms offer online access to digital books: the Sony Reader, the Apple iPhone (and soon the Apple tablet), Amazon Kindle, and Microsoft offering digital books. Although their scale does not compare with Google’s immense book database,

12 Id. at 2.1–2.12 (rev. Apr. 8, 1997).
13 See, e.g., RICHARD A. POSNER, ANTITRUST LAW 69–70, 75 (University of Chicago 2d ed. 2001).
14 The Revised Settlement, section 4.2.
these digital books should be able to substitute Google’s digital library of books in a great
degree, because they have been set up for several years and have some competitive advantages
based on clients’ loyalty. For example, Amazon currently dominates the market for
downloadable e-books and Microsoft has over 1 million full-text public domain scanned works
online now available on Internet Archive.\footnote{http://en.wikipedia.org/wiki/Google_Book_Search}

Additionally, traditional bookstores of physical books and libraries may arguably
constitute substitutes for Google’s new products. However, these physical books are mainly
determined by demand-side substitution. Demand-side substitution takes place when consumers
switch from one product to another in response to a change in the relative prices of the products.
An evaluation of the difference between the digital books Google plan to offer and the physical
books may be helpful to see how the physical books can or cannot substitute the new products.

First, under the settlement section 4.3, Google will supply Standard, Continuous, Fixed
Preview, or No Preview Books to a book searcher. Generally, Google may offer a free Preview
Use to allow users to sample a Book prior to making a purchase decision.\footnote{The Revised Settlement, section 4.3 (a).}
For example, a Standard Preview means that Google may display up to twenty percent (20\%) of the pages of a
Book to a user but no more than five (5) adjacent pages at a time.\footnote{Id., section 4.3 (b)(i)(1)} However, Google will not
offer to users copy/paste, print or Book Annotation functionalities as part of Preview Uses.\footnote{Id., section 4.3 (b)(i)(3)}

Second, under section 4.1 (d) and section 4.2 (a), all users can view, copy/paste, and
print pages of a Book, and make Book Annotations. However, they will not be able to select,
copy and paste more than four (4) pages of the content of a Display Book with a single
copy/paste command. Also, the users will not be able to select a page range that is greater than
twenty (20) pages with one print command for printing. How can these limitations work in
practice? Through section 4.1 (e)(3), which states that users can only make available the Books
to third party in Google’s database by hyperlinks or similar technology, it is clear that
electronic books purchased from Google will not reside on users’ computers. As Mr. Richard
Sarnoff concludes, the system Google has agreed to implement will not involve the transfer of
files.\footnote{Timothy B. Lee, Publisher speculates about Amazon/Google e-book "duopoly", available at
http://arstechnica.com/tech-policy/news/2009/02/publisher-speculates-about-amazongoole-e-book-duopoly.ars} Thus, users will not be able to read their e-books on their computers when they are out
of range of an access point. Despite this, section 4.7 authorizes Google to supply additional
services like Print on Demand, File Download, and Consumer Subscription Models when
agreed by the Registry.

Third, according to section 4.8, Google also offers free books access to public libraries
and nonprofit higher education institutions. For instance, there will be one terminal per library
building for each public library.
Fourth, for books in the public domain, Google will permit the user to download a PDF copy of the book for free like the Project Gutenberg, which is the first producer of over 30,000 free electronic books.\(^{20}\)

It is hard to predict how readers will respond to Google’s book project, which has not yet been put into the market. Accordingly, it is uncertain whether the traditional physical books can substitute the GBS’s products. For example, a hard-copy book’s ability to be taken anywhere in the world and accessed without computer or Wi-Fi connectivity is a real advantage over a digital version. However, if those physical books are considered to be substitutes, Google definitely will be released from the shadow of monopolization in book distribution due to the substantial competition from the traditional bookstores.

A last inquiry into the new market is what kind of different effects Google’s new product will bring to our society? In education, Google’s offering makes research significantly more productive. For the blind community, it opens the door of extensive knowledge by making digital reading of books available. For the copyrights-holders, the proposed settlement both discourages the illicit sale of e-books by taking several measures and providing an efficient means for lawful purchases. For consumers, it offers a wider choice of products and services. And for the environment, it saves trees by making books available without paper. Such an improvement in consumer welfare and economic efficiency should be the goal of the antitrust agencies’ review process.

B. Monopoly Power and Exclusionary Agreement

The DOJ and some scholars, e.g., Professor Samuelson and Professor Grimmelmann, assert that the agreement would give Google a monopoly on the largest digital library of books in the world, which will result in considerable freedom for Google to set prices and terms for Book Search’s commercial services.\(^{21}\)

Section 2 of Sherman Act punishes "every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize…".\(^{22}\) Under the leading precedents, the offense of monopolization under Section 2 has two elements. First, that the defendant possesses monopoly power in a relevant market and second that the defendant obtained or maintained that power through conduct deemed unlawfully exclusionary.\(^{23}\) In the instant case, Google as the first one to combine digital books with search engine may gain monopoly power through its superior skill and foresight for a limited period of time. Then potential competitors like Microsoft and Amazon will enter into the market competing with Google because the settlement agreement is not exclusive.

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\(^{20}\) http://www.gutenberg.org/wiki/Main_Page


1. Monopoly Power

A monopoly arises when a single firm, as the result of efforts to that end, previously competing businesses are so concentrated in the hands of a single person or corporation, or a few persons or corporations acting together, that they have power, for all practical purposes, to control the prices of a commodity and thus to suppress competition. In brief, a monopoly is the practical suppression of effective business competition which thereby creates a power to control prices to the public harm. There are three characteristics of a monopoly: i) single seller, ii) market power, and (iii) high barriers to entry and competition.

a. Single Seller

In a pure monopoly a single firm supplies the monopolized good. In the market for digital distribution of books, there exist several suppliers. Microsoft used to have a book-scanning program. Amazon and Sony together offer almost half a million books. Some publishers and authors offer digital books as well as some libraries have their own scanning projects. Professor Grimmelmann and Mr. Eric M. Frazer, however, claim that not even all of these projects combined could offer anything close to the breadth and depth of Google’s collection. Thus they claim that, Google will become the only player for scanning and searching books on anything resembling this scale. Indeed, making books digitally worldwide available and searchable requires a powerful search engine support and extensive economic investment. With the support of its economic scale, Google becomes the first firm to take digital books distribution to a totally new level. After Google successfully removes the legal barriers of establishing the market, however, it is foreseeable that the other competitors, especially those with comparable economic scale (e.g., Microsoft, Amazon and Yahoo) will come into play.

b. Market Power

Market power is the ability of a firm to alter the market price of a good or service without losing to its competitors a sufficient number of customers or sales to make the price increase unprofitable. A firm usually has market power by virtue of controlling a large portion of the market with a distinctive product. Thus, defining the relevant market is a prerequisite market power analysis. As discussed above, since Google’s plan of digital library of books has not yet come to date, it is uncertain whether physical books would constitute a substitute for the digital books on internet. It is clear that, however, if the relevant market includes physical books, Google should not be considered to have market power because traditional bookstores and libraries, as well as online sellers of hard-copy books offer substantial competition. Even if a court finds that the relevant market includes only digital books available on line, resulting in Google having a substantial market share at least for the a limited time period at the beginning of the market, Google still has two defenses.

27 James Grimmelmann, How to Fix the Google Book Search Settlement, 12 INTERNET L. No. 10, 10, 14
One defense is based on the theory that the higher the elasticity of demand, the lower the market power. Google will not be able to raise the price without losing many customers since the elasticity of demand in the general books market is very high. Also, a key to preserving the market power is to preclude competition through high barriers of entry. As analyzed below, the fact that there are no barriers for the potential competitors like Microsoft and Amazon to enter the digital books market will substantially limit Google’s ability to raise its price above competitive levels, at least in the longer term.

Even if Google has some market power over the market of digital books, it is impossible to say that Google has abused or will abuse that power through the terms of the settlement. Google makes freely available of (up to) 20 percent of the content of the books on the internet, and all of the content is indexed and searchable. Additionally, it provides a link to the libraries for all books search which allows a book user to get the book for free. Such provisions actually limit and undermine Google’s use of its market power.

c. High Barriers to Entry

Barriers to entry are obstacles in the path of a firm that make it difficult to enter a given market. Because barriers to entry restrict competition in a market, they are the source of a firm's pricing power - the ability of a firm to raise prices without losing all its customers. There are two major types of barriers to entry: economic and legal.

First, under Google’s ambitious scanning project, it is easy to infer that the economic barriers to enter into the market must be very high. It is reported that Google has spent about $100 million to scan the books, which includes seven million books digitalized to date and fifteen million books to be digitalized. And, from estimates of scanning costs and legal fees the overall cost to Google is to be in hundreds of millions of dollars. Such high cost is almost prohibitive as to prevent another company from engaging in a book-scanning project and competing with Google, however, it is not a problem at all for the potential competitors like Microsoft or Amazon.

From the point of the economies of scale, Google has a market capitalization of $180 billion, while Microsoft, Amazon, and Yahoo have $263 billion, $56 billion and $23 billion respectively. With such immense economic scale, none of these potential competitors would encounter funding problems for the capital requirements to compete with Google. Needless to say their ability to overcome the barriers as cost advantages and technological superiority that result from Google’s large economic scale. One argument is that since rescanning the books is so expensive and that effort would be wasted, Google should share its database with the competitors. Nevertheless, the baseline of antitrust law is that the cost of duplication is overcome by the value of competition. The closest example here is Lexis and Westlaw. In brief, with the fiscal muscle to use the best available technology, these companies could invest in

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29 http://finance.yahoo.com/q/ks?s=MSFT
parallel projects and compete with Google by different ways, e.g., using different scanning technologies or putting the resulting data in a different format.

Moreover, Google’s product, a digital library of books, is not goods without substitute. If a producer sells goods for which there is no close substitute, the absence of substitutes makes the demand for the good relatively inelastic enabling him to extract positive profits. Physical books, (either new books, or used books bought or borrowed through a secondary-market, such as libraries and second-hand or “remainder” bookstores), and the libraries’ free access of some digital books, however, constitute substitutes for the GBS for some degree. Finally, Google has not engaged in any conduct to exclude competitors or eliminate competition. Such as actions like collusion, lobbying governmental authorities, and force.

Second, there are legal barriers. Legal hurdles like the licenses of the copyrights may make it unfeasible for any other firms to build a search engine comparable to Google Book Search. It is not easy to get collective licenses from all the rights-holders, but Google will not be the only one able to surmount that barrier because the agreement entered into between Google and rights-holders is not exclusive as analyzed below.

2. Unlawfully Exclusionary Conduct

According to Frazer, the leading antitrust treatise provides the following definition of exclusionary conduct: [A]cts that: (1) are reasonably capable of creating, enlarging, or prolonging monopoly power by impairing the opportunities of rivals; and (2) that either (2a) do not benefit consumers at all, or (2b) are unnecessary for the particular consumer benefits claimed for them, or (2c) produce harms disproportionate to any resulting benefits. Some argue that the agreement entered into between Google and the copyrights holders constitutes an unlawfully exclusive conduct prohibiting competition. However, under section 2 of Sherman Act, the mere fact that conduct disadvantages rivals does not, without more, constitute the sort of exclusionary conduct that satisfies the requirement. Instead, such conduct must exclude rivals on some basis other than efficiency.

It is clear that the book settlement agreement does not contain any exclusivity provision. Nothing in the settlement prevents anyone involved from doing separate deals with others. For example, follow-on competitors can work with the Registry to license the claimed books. Authors will gain the right to allow their works to be distributed under the license of their choice, including Creative Commons licenses as well. Moreover, a clause that required the Book Registry to grant Google any deals given to other businesses (termed "most favored

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33 The Revised Settlement, section 6.2 (b)
nation")) was also dropped. Accordingly, any potential competitors attempting to follow Google into the digital-book distribution may be able to obtain better terms than Google. In short, as Professor Grimmelmann points out, Microsoft could have a book-scanning program again. Authors could license Yahoo to scan, index, and sell. The Registry could split the take. And libraries could subscribe to Yahoo’s version.

Nonetheless, opponents argue that because potential entrants probably cannot duplicate the agreement that Google will have with almost all copyright owners, as a factual matter, only Google would have the ability to market to libraries and other institutions a comprehensive digital-book subscription. This is also known as de facto exclusivity. Specifically, Frazer states that three key components of the settlement make it difficult for a potential competitor to ever fully enter this market: i) the simultaneity of the agreements with rights-holders, ii) the opt-out provision, and iii) the inclusion of orphan works, make it difficult for a potential competitor to ever fully enter this market. He goes further to claim that such features reduce transaction costs for Google to nearly zero, while competitors would face very large costs in making agreements with each active rightsholder.

However, the proposed settlement also releases the potential competitors from transaction costs. If the agreement gets approved by the court and the DOJ, then Google would remove the legal hurdles for some degree for the potential entrants. By making this risky investment, Google at least provides a legal as well as a negotiation framework for the follow-on competitors. Furthermore, by establishing an independent intermediary, the Registry, potential competitors can get a collective license from the Registry. And they can just make deal with the Registry for profitable books only. However, because the Registry can only act “to the extent permitted by law”, which means the Registry will lack the ability to license the orphan books to the competitors, no one can offer to the public anything like the full set of books Google can offer. Actually, as analyzed below, orphan books that are commercially valueless do not constitute core competitiveness in the market.

Some argue, however, there is no incentive for the rights-holders to voluntarily license their digital works to allow new entrants competing with Google. This is not true. First, the Registry can always do a better deal with competitors, e.g., a higher fixed royalty rate. Second, Professor Picker neglects that additional platforms will shift the demand curve outwards. For publishers, the more distribution platforms they have, the higher the demand for their products, which will lead to greater royalty payment exceeding the profits arising from a higher price on a smaller quantity of books sold.

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34 Pre-revised Settlement, section 3.8 (a)
35 James Grimmelmann, How to Fix the Google Book Search Settlement, 12 INTERNET L. No. 10, 10, 14.
36 DOJ’s Brief, at 25.
38 Id.
39 The Revised Settlement, section 6.2 (b)
Another way to gain access to the full market is another class action lawsuit. In other words, the potential competitors could infringe and get sued by following Google’s path. Opponents criticize that this is not ordinary business risk by breaking the law and risking statutory damages of up to $150,000 per book and possibly criminal penalties including jail time. DOJ also objects that it is not a sound policy to encourage law breaking.

Google, however, has some strong responses. First, it is not unfair for the other companies to have to take such lawsuit risk, because Google’s willingness to take the risk is what will confers the competitive advantages over those who are unwilling to take the risk. Second, since Google has already shown the path to achieving a legally satisfactory position, it should be reasonable to expect that another class action should not be substantially different from this one. Finally, although it may not sound policy, me-too lawsuits may be a necessary way to creatively solve the conflicts between the legislation’s inaction and society’s need to have a full access to books. Additionally, the potential competitors can lobby Congress for orphan works legislation.

However, some are concerned that the settlement would eliminate the fair use defense and make it realistically impossible for any competitor to do what Google has done. Under the fair use doctrine, one can argue that its copying activity is for socially valuable service, and finding and paying all those copyright owners would be prohibitively burdensome. Professor Gibson argues that the settlement itself is proof that a company can pay licensing fees and still turn a profit. So now no one can convincingly argue that scanning a book requires no license. Actually, questions of fair use can be terribly uncertain. Few defendants will wait to see their fair use claims all the way through. Additionally, a settlement is not a legal precedent which binds a later case in trial.

Therefore, Google does not create an exclusionary agreement to gain monopoly power in the digital books market (if there is such a market) by impairing the entry and competition opportunities of the potential rivals. Meanwhile, the agreement is necessary for supplying customers full access to the books when legislation on orphan works is not yet available. The resulting benefits for availability of orphan books outweigh the opponents’ unsound policy concerns.

C. Orphan Books

Many critics have argued that the Google Books Settlement gives Google a monopoly on orphan works. Orphan books are books that retain their copyright but for which the rights holders are unknown or cannot be found. An opt-out provision in the class action settlement makes it possible for Google to include orphan books in its book search service. Professor Picker and Professor Grimmelmann worry that the settlement grants Google an initial

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43 DOJ’s Brief, at 25
monopoly on the use of orphan books and might be used in the future as an exclusionary device to keep subsequent entrants from having access to orphan books. This paper will evaluate how much the orphan books will affect competition in the digital books market.

First, what percentage of the books are orphan books? Professor Samuelson states that 70 percent of books are in copyright but out of print. Pointing out that Professor Samuelson ignores the fact that a large proportion of publishers can be located (e.g., foreign works authors, who could be easily located but who have chosen not to sign up with the Registry), Professor Peter Hirtle estimates the percentage of orphan books to be 12 percent based on Denise Troll Covey's method of a random trial. Agreeing with Professor Hirtle’s methods, Professors Hausman and Sidak reach a slightly different estimate of the orphan books as 9 percent. While the actual number of orphan books is highly uncertain, the number should become smaller since some rights holders might come forward via or after the settlement. Moreover, Google and two author and publisher groups have revised their settlement on the rights to access and distribute millions of out-of-print books, narrowing the scope of books involved.

Second, what’s the value of the orphan books in the market for competition? Orphan books are out of print, which means they have the least reader demand and accordingly the least commercial value. Besides this, the cost to find the rightsholder and clear the rights for a potential license could be very high. It is not unreasonable to expect that such cost may outweigh the potential profit from re-publishing the books. Combined with the number of orphan books, it is really hard to believe that a license to use such books could give Google any extraordinary market power. Some may argue that, however, because of the low elasticity of demand for orphan books, Google would be able to charge a high price on these works. It is true that the elasticity of demand for orphan books may be low, but the fact of the availability from other suppliers (i.e., libraries and used bookstores) and the possibility of new entrants, would greatly restrain Google’s ability to charge a high price.

Third, what kinds of effects would Google’s book deal to embrace orphan books have on the market? In practice there would be two impacts.

(1) The settlement will advance competition in the book market by expanding access to orphan books. Currently, orphan books are only available through libraries and used bookstores (including online vendors). Through the settlement, Google would not only make orphan books available by internet, but also make the libraries and used bookstores searchable and locatable to the buyer. By expanding the availability, Google will stimulate demand for digital books as well. Accordingly, authors and publishers will get revenue from these orphan works. Also, libraries will be authorized to provide free and complete access to orphan books at terminals in

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45 See, e.g., Picker, at 386; Grimmelmann, at 14.
46 Samuelson, Legally Speaking, at 1.
their buildings. In short, consumers will be better off rather than worse off as a result of the settlement.

(2) Rather than limiting new entries, the Google Books settlement is the only way to get cost-effective access to orphan books. By making this creatively risky investment, Google actually lowers the barriers and risks for the follow-on competitors. Although they cannot get the license of orphan books from the Registry, they can obtain it by following Google’s lawsuit path. Though not perfect, it helps to fix a market imperfection (the inability to locate orphan rights-holders and the high transactions costs of negotiating) pending a legislative fix.

Fourth, does Google Books settlement prevent Congress from legislating on orphan books? No. Congress of course can fix any problems with the proposed settlement by passing orphan works legislation. Any law passed to loosen restrictions on the use of orphan works would take precedent over Google's settlement. However, by expanding access to orphan books, the settlement will help to force Congress to act. And probably may offer a working model for Congress to develop a successful legislation on orphan works. Nevertheless, there is one concern left open. What if the settlement is conflict with the subsequent legislation on orphan books? Although the settlement claims that the enforcement of the agreement should not violate any applicable law, it is unclear whether the parties intend the “applicable law” including the afterwards legislation.

Finally, will Google treat the revenues from the orphan books fairly? Google's revised book settlement appoints an independent fiduciary to oversee the license fees collected for orphan works, or books whose authors are unknown or unable to be found. Revenue for unclaimed works will be held for 10 years, and the fiduciary will be able to spend part of that revenue (up to 25%) on a search for the rights-holders of these works. After that, the remaining funds will be used for charitable purposes consistent with the interests of publishers and authors. This suggests that, at least, Google is trying to deal with the orphan books fairly.

D. Refusal to Deal and Price Discrimination

Refusal to deal is one of several anti-competitive practices forbidden by the Congress. Under the settlement’s section 3.7 (e), Google has a right to exclude particular Books from being displayed for editorial or non-editorial reasons. If the exclusion of a book is for editorial reasons, Google agrees to notify the Registry. Then, the Registry can authorize a competitor to provide the display services of that excluded book.

Professor Grimmelmann raises concerns of refusal to deal about this provision. He is worried that the Registry may not be able to find an alternative to Google for digital distribution. According the above analysis on the barriers to entry, at least Microsoft and Amazon could replace Google’s e-books distribution service. In addition, Google defends its right to exclude under the First Amendment, because Google has the right not to be forced to

49 The Revised Settlement, section 17.34
50 Id., section 6.1 (c) and section 6.3(a)(i)
51 Id., section 3.7 (e)(i)
52 James Grimmelmann, How to Fix the Google Book Search Settlement, 12 INTERNET L. No. 10, 10, 18.
“speak” (publish) words that it disagrees with. Nonetheless, the book authors and the public also have the same freedom. To balance this conflict, Google should set up some safe-guards against the possible abuse of its market power. As Professor Grimmelmann suggests, first, Google should be required to inform not only the registry but also the general public when it decides to exclude a book for editorial reasons; second, in order to distinguish from non-editorial, Google should supply a clear and precise list of editorial reasons, which says “excluded not for quality, user experience, legal, or other non-editorial reasons” under current draft.  

Professor Grimmelmann also expresses concerns about price discrimination. Price discrimination exists when sales of identical goods or services are transacted at different prices from the same provider. Professor Grimmelmann claims that the settlement does not explicitly prohibit Google from charging different readers different prices for the same book. And, he believes that it is feasible for Google to charge different price for a same book by its immense computational power and huge pricing corpus. However, Professor Hausman disagrees. According to Professor Hausman, under the GBS’s competition strategy, the information requirements for price discrimination are extremely high. Google cannot gather sufficient information to charge individual customer-based prices.  

III. IS GOOGLE’S DEFAULT PRICING A PRICE-FIXING?

Not only does Google’s competitor Amazon fear that the proposed settlement would create a pricing mechanism that is fraught with the dangers associated with price-fixing, but the DOJ also raises the concern that features of the agreement bear an uncomfortably close resemblance to quintessential per se violation of the Sherman Act. According to DOJ, “the collectively negotiated provisions of the Proposed Settlement appear to restrict price competition among authors and publishers: (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.” Some scholars, like Professor Picker also express dislike of the “pricing algorithm” that Google will design to maximize revenue for each rights holder. A detailed analysis below will help to ease such concerns.

First, under the proposed settlement, the authors and publishers have a fixed royalty rate at 63% of all revenues Google earns through the GBS. See § 2.1(a). At first glance, it does look like imposing restrictions on competition among authors and publishers at the wholesale level, which conflicts with the current competition among publishers to get their books distributed.

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53 Id.
54 Id, at P16.
55 For a detailed analysis, please see Professor Hausman and Professor Sidak’s paper “Google and the Proper Antitrust Scrutiny of Orphan Books”, P422-424.
57 DOJ’s Brief, at 16.
58 Id., at 17.
Nevertheless, this difference is justified by the big change brought by Google’s GBS program in the industry. The mission of the GBS is to make all books available worldwide through the internet. Under such mission, the authors and publishers no longer need to compete to get their books to be distributed by Google, because Google has to distribute all their books to achieve it. Such a change does reduce the traditional competition among publishers. But it generates great economic efficiency to meet the new technology development in the book market. It is hard to imagine how a worldwide digital library of books could be achieved if Google had to negotiate individually with every author. Furthermore, there is at least some space left to the traditional competition among publishers and book distributors. Some individual authors or publishers might opt out of those terms if they are dissatisfied with the 63% royalty rate. For example, they could individually renegotiate with Google or just turn to Google’s competitors, like Amazon, Yahoo, and Microsoft, etc. Finally, this fixed royalty rate is not a price fixing because the unit price of each book still be subject to competition.

Second, the agreement also directs Google to set a “settlement controlled price” as a default price for consumer purchases if the book’s rightsholder does not set the price. Pursuant to the definition of the “settlement controlled price”, Google will develop a pricing algorithm to slot books into particular pricing bins in order to find the optimal price for each book and, accordingly, to maximize revenue for each rightholder. The initial distribution of prices across bins will be: 5% of the books will be priced at $1.99, 10% at $2.99 and so forth until reaching a top price of $29.99 for the final 5%.

Based on these provisions, Professor Fraser claims that this pricing option, “turning over pricing power to Google, concentrates decision-making power in one firm and allows Google to coordinate prices across products to achieve industry-wide cartel behavior.” Professor Picker agrees, and argues that the rights-holders are collectively appointing Google as their sale agent, which will fail a challenge under Section 1 of the Sherman Act.

The threshold question here is whether Google is a sale agent as a cartel for the righsholders to fix price? No, because the proposed agreement is not strictly a horizontal agreement among competitors to fix price or restrict output. A cartel under the Section 1 of the Sherman Act, which prohibits “agreement, conspiracies or trusts in restraint of trade”, requires proof of an actual agreement between horizontal competitors. Additionally, like ASCAP/BMI (holding that the blanket licenses issued and priced by the music performing rights organizations ASCAP and BMI were not subject to per se invalidation under Section 1), Google and the Registry together serve as intermediaries to reduce transaction costs. They allow for new, integrated products entirely different from the product that any one competitor

60 The Revised Settlement, section 4.2 (b)(i)(2).
61 Id., section 4.2 (c)(ii).
66 BMI, 441 U.S. 1, 2 (1979)
was able to sell by himself. Here, the new product is the whole idea of a worldwide digital library of books, which obviously cannot be realized by any one author or publisher.

Frazer argues that because Google did not make a series of independent vertical agreements like ASCAP, the facts are closer to a cartel. Arguably, the agreement is not a horizontal collective action by publishers and authors but a unilateral vertical offer by Google to each individual rightsholder to contract on specified terms. ASCAP, however, demonstrates that multiple vertical agreements can still result in a §1 violation. Thus, the court imposed DOJ consent decrees on the ASCAP to balance the benefits of economic efficiency and consumers’ welfare and the danger of cartel behavior through centralized decision-making. Nonetheless, because Google agrees authors and publishers to set and change price independently and freely, and the settlement is not an exclusive agreement as ASCAP, it is unlikely that Google can exercise any cartel-like power to fix the price and, accordingly, a consent decree is unnecessary here.

Further, how different will the prices set by direct competition among rights-holders be from prices set by Google’s default pricing algorithm? Frazer and Professor Picker both think that in a competitive market, if the copy cost of a digital book is zero, then the competition among rights-holders would push prices towards zero. This is incorrect.

For one thing, pricing is not decided by the goods’ incremental cost. Rather, price is affected by demand, even under a monopoly market. For a differentiated product (e.g. a book), the demand curve will decide its price no matter how much its cost is. Professor Hausman and Sidak make a good example to illustrate this theory. “For example, the cost of creating another copy of software is near zero, regardless of whether it is a very successful application (like McAfee anti-virus software or TurboTax software) or an unsuccessful computer game that few people know about or purchase”. It is obvious that, nonetheless, the price of the former would be much higher than the price of the latter. Actually, for a differentiated product, if the marginal cost is near zero, the resulting outcome is approximately equal to maximizing revenue because every producer of a differentiated product would attempt to maximize profits. Thus, whether under a direct competition or Google’s pricing algorithm, the pricing for a differentiated book would not be substantially different.

For another, the centralized decision-making power of Google is not different from the pricing of competing rights-holders on the availability of perfect information. For pricing under a free competition market, the development of the price is showed by the curve A with great variance. The competitors in such a market will have to adjust their price from time to time. In contrast, pricing under an algorithm, i.e., Google, the development of the price is almost a smooth line as the curve B with only minor variance. An algorithm does not mean that perfect

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68 DOJ’s Brief, at 18.
70 Id.
information is available, it just helps Google to find the most stable and reasonable price. (See the picture below)

In other words, no matter whether there is direct competition or a collective pricing algorithm, the final price expectation (or, let’s say the pricing) for a differentiated book would reach a stable point. The only difference between them is the way to reach the stable point and, “the loss in economic efficiency and consumer welfare that would occur if GBS could not effect agreements with the rights holders acting individually.”

Finally, some worry that Google may use its centralized decision-making power to charge a high price. Actually, there is no incentive for Google to charge a high price. The Amended Settlement clarifies that the Pricing Algorithm used to establish the Settlement Controlled Prices for Consumer Purchases will be developed to simulate the prices in a competitive market and that the price for a Book will be established without regard to changes to the price of any other Book. What will happen if Google charges high prices? First, the monopoly profit will attract more entrants to compete with Google. Second, even if there is no other entrant to compete with Google, charging a high price by constraining the consumers’ demand will result in an extensive violation of Google’s use restriction policy in the digital books. A good example is Microsoft’s software sold in China. Because Microsoft charges a high price, consumers who want the software but cannot afford for it will turn to an illegal copy. Google must consider the ease with which a rival could illegally copy Google’s digital books database. If copying is feasible, then Google must worry that high prices would lead to its being a litigator on the copyrights violation rather than a business for profit. Even if Google wins in all cases, how much can it collect from a judgment? Therefore, as a business seeking healthy development for the future, Google has no reasonable incentive to charge high prices.

Third, the settlement also sets out two objectives of subscription pricing: “(1) the realization of revenue at the market rates for each book and license on behalf of rights-holders and (2) the realization of broad access to the books by the public.” While the same concerns about price fixing were raised here, and the above analysis about price fixing applies as well. A different issue raised from subscription pricing is that the allowable discounts Google can offer

71 Id.
72 The Revised Settlement, section 4.1 (a)(i)
to the institutional subscription are limited to 10% off a book’s list price. Additional discounts will require Registry approval. DOJ claims that such collective restraints on discounting have been held to be per se violations of Section 1. First, there is not a total ban here on discounts, which means that the precedents are not strictly applicable. Second, Section 1 of the Sherman Act prohibits only unreasonable restraints of trade. The 10% discount limit here could arguably be reasonable depending on the usage of trade in the book industry. Anyway, the agreement carves out an exception for the discount limit: additional discounts can be renegotiated with the rights-holders.

CONCLUSION

On October 9, 2009 Google announced that the number of scanned books is over 10 million. As one of the most far-reaching class action settlements in United States, if the settlement is approved, Google (and soon Microsoft and Amazon as well) will be able to create a vibrant marketplace for the electronic distribution of copyrighted works, including in-print, out-of-print, and so-called “orphan” works, making information accessible regardless of one's geographic location or financial status. The antitrust concerns about the settlement should be dispelled because the settlement does not grant Google any exclusive set of rights or result in any one entity gaining control over access to and distribution of the world’s largest digital database of books. Of course, other concerns about the copyright law, manipulation of search results, long term preservation cost, and privacy protection, have been excluded from this paper. However, the court’s approval of the settlement will be likely turn on the antitrust law issues. Here at least the court should have no concerns.

73 Id., section 4.5 (b)(iii)
74 Id., section 4.5 (b)(iv)
75 See Catalano, Inc. v. Target Sales, 446 U.S. 643, at 648 (1980) (ban on extending credit is “tantamount to an agreement to eliminate discounts, and thus falls squarely within the traditional per se rule against price fixing”). See also DOJ’s Brief, at 21-22.
76 http://en.wikipedia.org/wiki/Google_Book_Search