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I. INTRODUCTION

Proper analysis of the Google books settlement requires framing the issues correctly in two important respects. First, it requires understanding that sound antitrust analysis turns on likely effects on consumer welfare, not on debatable spins of arid formalisms. Second, it requires measuring those effects compared to the but-for baseline of what the world would look like but for the settlement.

Given the proper framing, the right question to ask is: Does the settlement lower consumer welfare from what it would be without a settlement? It is not an antitrust violation to enter into an agreement that benefits consumer welfare on the theory that another agreement could have benefitted consumer welfare even more. Otherwise every joint venture could be stricken on the grounds that it would benefit consumer welfare even more if the joint venture offered its product for free.

Nor do I know of any case that has held that authorities can disapprove a settlement between two parties that benefits the public interest on the ground that the settlement could have benefitted the public interest even more. The power to protect against settlements that harm the public interest is not a license to threaten settlement disapproval to expropriate as much from the settling parties as possible, even if the expropriation is done in the name of benefitting the public. Distorting the settlement approval process in that fashion is not in the long-run best interests of the public interest, for at least two reasons. First, the authorities might get the game theory wrong, blowing up settlements and preventing any benefit to the public interest. Second, expropriating as much as possible of the joint gains will discourage ex ante investments to create those joint gains in the first place.

So the right question to ask about the Google books settlement is not whether one could imagine some alternative settlement that might benefit consumers and the public interest even more than the actual settlement. Rather, the right question is whether the settlement leaves consumers and the public interest worse off than they would be in the but-for world without the settlement, and there is simply no reason to think it does.

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[1] Petrie Professor of Law, Harvard Law School. This piece is based on the more detailed analysis in Elhauge, *Why the Google Books Settlement Is Procompetitive*, available at http://ssrn.com/abstract=1349971, which provides cites to support various factual claims I rely on here. I am grateful for funding from Google Inc. The views expressed here are my own, and should not be taken to reflect the views of Harvard University or Google.

II. RIVAL ENTRY BARRIERS

One of the biggest critiques of the settlement has been the claim that it will create a de facto monopoly because rivals won't be able to enter the market to compete with Google. There are certainly entry barriers to distributing a comprehensive set of digital books—chief among them being the costs of digitizing books, the transaction costs of licensing rights, and the risk-bearing costs of buying invalid or worthless licenses. However, while the settlement overcomes those entry barriers for Google, it does nothing at all to increase them for rivals because every right the settlement gives Google is expressly nonexclusive. Although it can be an antitrust violation to raise rival entry barriers, it is not an antitrust violation to invest in overcoming entry barriers for oneself without helping rivals fully overcome them. It is not illegal to invest to get a first-mover advantage.

Far from increasing rival entry barriers, the settlement actually affirmatively lowers them in a number of ways. It lowers rival digitization costs because it allows rivals to buy the digitized copies that Google made of out-of-copyright books from participating libraries. The settlement also significantly lowers rival transaction and risk-bearing costs in a number of ways. First, the settlement creates a public database to identify rightsholders and which books are out-of-copyright, allowing rivals to avoid costly identification efforts and lowering rival risk in offering books. Second, it helps rivals value digital books by revealing the extent of buyer demand for them, thus helping rivals decide which books to license for digital use. Third, the settlement funds a search for rightsholders of unclaimed (orphan) books, allowing rivals to avoid the transaction costs of finding them or the risks of offering unclaimed books without a license.

Finally, the settlement creates a Registry that is authorized to license book rights to Google's rivals "to the extent permitted by law." This raises two possibilities, depending on what one thinks the law permits a class action settlement to cover. If a class action settlement can legally give the Registry authority to give rivals the same default licensing rights that Google gets under the settlement, then the settlement does give the Registry that authority over all books, including unclaimed books. If the settlement cannot legally give the Registry that sort of authority, then the Registry can license Google rivals only to the extent that the Registry gets post-settlement authority from the rightsholders to do so. But either way, the settlement, by definition, did all it legally could to allow Registry to license Google rivals.

III. OUT-OF-COPYRIGHT BOOKS

Many out-of-copyright books from 1923-63 have not been offered by Google or its rivals because of the transaction costs of resolving their out-of-copyright status and the risk of offering them without such a resolution. Without the settlement, that situation would continue. For these out-of-copyright books, the but-for output would be zero, and the effective price would be infinity. With the settlement, Google will resolve the status of these out-of-copyright books and offer them for free. Further, rivals can offer the same books, free riding not only on Google's costs of resolving their status but also on its digitization costs by buying the digitized copies Google made from participating libraries. Thus, with the settlement, the output will increase from a baseline of zero, and the price will drop from infinity to zero. This is all a boon to consumer welfare.

IV. UNCLAIMED (ORPHAN) BOOKS

The biggest controversy about the settlement has been about orphan books. I prefer to call them unclaimed books because these books do have parents, their parents just are unknown. But whatever we call them, the settlement's effects on their distribution is, contrary to the critics, entirely desirable.

If the settlement is banned, both Google and its rivals will be unable to offer orphan books. Their but-for output would be zero, their effective price infinity, and their rightsholders would get nothing. With the settlement, Google will offer currently orphaned books either at an algorithm price or a price set by whichever rightsholders are found through the settlement. Google's rivals will be able to license the same books by any found rightholders. Google's rivals may even be able to offer books by unfound rightsholders depending on how the Registry's authority is interpreted or if rightsholders can trigger a similar class action settlement as Google; to the extent rivals cannot, it would be because of legal obstacles that are not created by the settlement and would have equally existed in the but-for world.

Thus, the settlement would clearly increase the output of orphan books from zero to something, and lower the price from infinity to something lower, even under the worst case assumptions that no rivals will ever enter, no rightsholders of orphan books will be found, and the algorithm price will be supracompetitive. The effects on orphan books are thus entirely beneficial to consumer welfare even under worst case assumptions. In fact, the benefits to consumer welfare are even greater because there is some chance rivals could enter this market, it is implausible no rightsholders would be found, and the algorithm price is (we shall see) designed to mimic competitive prices. Further, with the settlement, rightsholders in orphan books will get some royalties, and thus will also be better off than without the settlement.

V. CLAIMED OUT-OF-PRINT BOOKS

Out-of-print books are, by definition, books that are not currently being sold. Without the settlement, this situation would continue and neither Google nor its rivals would offer these books. Their but-for output would be zero, their effective price would exceed buyer willingness to pay, and their rightsholders would get nothing. With the settlement, Google will offer these books either at either an algorithm price or an author-set price. Further, rivals can license these same books at competitive prices. Thus, the settlement will clearly increase the output of out-of-print books and lower their prices—even in the worst case scenario where rivals don't license any books and both the algorithm price and author-set prices are supracompetitive—and even more so under more reasonable assumptions that rivals would license books that prove profitable and that prices will be competitive. Rightsholders in claimed out-of-print books will get some royalties, and thus be better off than in the but-for world.

VI. IN-PRINT BOOKS

Without the settlement, Google and rivals have offered some in-print books and will presumably continue to do so. With the settlement, Google will offer some in-print books at an algorithm or rightsholder-set price, and rivals will offer them at competitive prices. More important, readers will be able to find in-print books more easily via searches of a comprehensive library, and Google's search engine will direct readers to where they can buy the book from Google and its rivals. This should increase the output of in-print books. Further, increased competition from out-of-print books should put some downward pressure on in-print book prices. Finally, the settlement will lead to a brand new product—institutional subscriptions for a comprehensive library of books, including any in-print books that rightsholders choose to distribute in this fashion. Although the procompetitive effects are not quite as dramatic as for other book categories, the effects remain beneficial to consumer welfare.

VII. POST-SETTLEMENT PRICING AND ROYALTIES

If rightsholders don't set their own prices, the settlement allows Google to set prices using an algorithm, which some have claimed amounts to allowing cartel pricing. But this algorithm does not allow Google to set supracompetitive prices for all books collectively. Instead, Google must set a price for each individual book that maximizes its revenue given the other book prices. This is a competition-mimicking formula designed to produce the prices that competitive rightsholders would set if they had the time and information to set their own book prices. Although I think this is fairly clear from the settlement language, if it were thought at all ambiguous, a standard canon of construction calls for interpreting contracts to promote competition, and the courts could easily condition approval on such an interpretation. Moreover, even if Google tried to abuse the algorithm to set supracompetitive prices, such efforts would be undermined because each rightsholder would have incentives to defect from such a cartel price by setting a slightly lower price for its book, causing cartel prices to unravel. Thus, the settlement will achieve competitive book pricing for digital books sold through Google even to the extent rivals don't enter the market for offering them digitally.

Another concern has been that the 63% royalty that Google gives rightsholders under the settlement might be too high or too low. This concern seems misplaced. If Google's 37% distribution margin were too high, then rightsholders and the Registry would certainly have incentives to license Google rivals to undercut that margin and keep more profits for themselves. If the 37% margin were too low, that would mean it did not suffice to fund efficient distribution efforts, and rightsholders and the Registry would have incentives to pay a higher margin to induce more efficient distribution.

In any event, there is no way to offer orphan books or a searchable universal library without setting some default royalty rate and pricing mechanism. Nor, without some commitment by Google to royalties, would rightsholders have incentives to agree even to snippet displays of their books. Banning this feature thus not only would harm consumer welfare by denying buyers access to orphan books and a searchable universal library, but would likely derail the settlement and lead to an adjudication that might deny readers access to book searches in general.

VIII. HORIZONTAL PRICE-FIXING?

Much of the critique of the settlement seems to be premised on the notion that it amounts to horizontal price-fixing and thus must be condemned even if its effects are entirely desirable. This is mistaken. To begin with, all the settlement provides for is a series of post-settlement offers by Google on pricing and royalties that individual rightsholders can accept or reject. This is just like any publisher that makes a standard-form offer to many authors, except the settlement is less restraining because publishers generally do not allow authors to also sell the same book through rivals or set their own prices through the publisher, and publishers are free to set book prices to reduce competition between books offered by the same publisher. Given that such a series of publisher-author agreements is deemed vertical, there is no reason to view the series of Google-rightsholder agreements as any less vertical.

To be sure, during the settlement negotiations, the rightsholders were collectively represented by class counsel. But one cannot properly deem any demand they made for a 63% royalty during those negotiations as a horizontal price-fixing agreement because it lacked the crucial feature of such an agreement in that it could not withdraw the option of individual sales. A cartel can force a buyer to pay an excessive price only if it couples the offering of a collective price with an agreement to take away the option of individual competitive prices. Without the latter, any buyer could simply choose the latter option and defeat any excessive price. Here, the rightsholders during the settlement could offer a royalty rate they would accept, but they could not take away the ability of Google to reject the settlement offer and license books individually if Google thought the royalty rate was excessive.

At worst, one might say that this sort of agreement had mixed horizontal-vertical features. If so, then the most relevant precedent are cases involving dual distribution agreements, which make clear that, even though such agreements have horizontal aspects, their classification should not turn on overly simplistic formalisms, but rather on a substantive assessment about whether the agreement is likely to have pernicious anticompetitive effects with no redeeming procompetitive virtue.[2]

Indeed, even if the agreement were properly classified as involving a horizontal price-fixing agreement, BMI makes clear that, if ancillary to a productive joint venture, such an agreement must be assessed under the rule of reason. The procompetitive effects of this settlement are quite similar to those in BMI. In both cases, the agreements created the new product of a blanket license in copyrighted works (here books, there songs) and lowered

[2] Copy–Data Systems v. Toshiba America, 663 F.2d 405 (2d Cir. 1981); Abadir & Co. v. First Mississippi Corp., 651 F.2d 422 (5th Cir. 1981).

transaction costs to licensing those songs without taking away any but-for option of individual transactions outside intermediary. That was sufficient to sustain the BMI agreement under the rule of reason. But the settlement here is even more procompetitive than the one in BMI because the settlement here also allows: (1) individual sales by the intermediary, which was the remedy sought by the BMI plaintiff; (2) rightsholders to set their own price for sales through the intermediary, a competitive right not even dreamed of in BMI; and (3) rightsholders who sell through one intermediary to sell the same work through rival intermediaries, something that was affirmatively prohibited in the agreements sustained in BMI.

IX. THE DOJ BRIEF

The DOJ brief asserted that the settlement raised serious antitrust concerns but responded to none of the above problems with that position. Nowhere does the DOJ brief make any effort to describe what it thinks the but-for world would look like without the settlement, nor does it offer any model or mechanism as to how the settlement might lead to worse results than the but-for world.

To support the assertion that the settlement forecloses Google rivals, the DOJ brief cites almost exclusively to a series of barriers to rival entry that were not created by the settlement and would apply equally without any settlement.[3] The only exception is that the DOJ mentions the settlement's most-favored nation clause, but its brief never explains how having the same costs as Google for unclaimed books could discourage a rival from entering a market that (by hypothesis) would have supracompetitive prices. Nor does the brief explain how equal costs for unclaimed books could matter if the brief were right that rivals could not offer unclaimed books at all given other entry barriers that the settlement didn't create.

For the rest of its analysis, the DOJ brief relies on an assertion that the agreement is a horizontal agreement rather than a series of vertical ones.[4] The DOJ argument on this point is entirely formalistic, and never engages the sort of functional analysis required by antitrust case law. The DOJ simply ignores the fact that most of the relevant categories of books would have zero output and effectively infinite prices without the settlement. The DOJ never addresses the implications of the fact that individual rightsholders can undercut any anticompetitive price or royalty rate and offers no explanation about how the agreement could lead to supracompetitive prices or royalties given this fact. Finally, the DOJ simply asserts the provisions on pricing and royalties are unnecessary to the settlement without offering any explanation of how Google could otherwise offer a searchable universal library and why rightsholders would have any incentive to agree to an alternative settlement in which Google makes no commitment other than to possibly negotiate future individual book distribution if Google wanted to do so.

At this stage, the DOJ position is thankfully tentative, and it is possibly significant that Assistant Attorney General Varney did not sign the DOJ brief. Perhaps further analysis and

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[3] Statement of Interest of the United States Regarding Proposed Class Settlement, *The Author's Guild v Google Inc.*, 05 Civ. 8136 (DC), S.D.N.Y., filed Sept. 18, 2009, at 23-24.

[4] *Id.* at 17-18.

negotiation will lead the DOJ to different conclusions. I hope so, because if the DOJ sticks to these positions, then it is hard to see how the DOJ could agree to any settlement that offers a near-universal searchable library or that rightsholders would have any incentives to accept. If the DOJ does stick to those positions, the trial and appellate courts should reject them to avoid the massive harm to consumer welfare that would result from blocking this settlement.