UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

UNITED STATES OF AMERICA, Plaintiff, v. APPLE, INC., et al., Defendants.	Civil Action No. 12-cv-2826 (DLC)

THE STATE OF TEXAS; THE STATE OF CONNECTICUT; et al., Plaintiffs, v. PENGUIN GROUP (USA) INC. et al., Defendants.	Civil Action No. 12-cv-03394 (DLC)

UNITED STATES' OPPOSITION TO APPLE INC.'S MOTION IN LIMINE TO EXCLUDE CERTAIN EXPERT TESTIMONY OF PROFESSOR RICHARD GILBERT

Apple's motion *in limine* is nothing more than a "tit for tat" attempt to deflect attention away from the serious failings that pervade the analyses of its own experts, Dr. Murphy and Dr. Burtis. Plaintiffs disclosed to Apple that they planned to move to exclude certain testimony on three of Dr. Murphy's opinions because, *inter alia*, they relied on no economic or empirical analysis of any kind for the conclusion that Apple acted in its own interest in fixing the retail price of e-books. Apple's own motion *in limine* then argues that Professor Gilbert's expert report is essentially "120 pages . . . much of which merely recount the 'evidence' on which the DOJ's case rests."[1] Similarly, Plaintiffs pointed out to Apple that Dr. Burtis's decision to analyze anticompetitive effects using a two-year window without controlling for any confounding factors rendered her opinion unreliable under Federal Rules of Evidence 401 and 702. Apple's own motion *in limine* then argues that Professor Gilbert's output analysis, which examines the effects of the conspiracy using a shorter window of time immediately before and after the move to agency, is "an unreliable empirical analysis."[2]

It is unclear how Apple can argue in the *same* motion that Professor Gilbert both (1) conducted no economic analysis and (2) reached conclusions based on improper economic analyses. But, putting that aside, even a cursory glance at Professor Gilbert's testimony and report makes clear how baseless Apple's assertions are. Professor Gilbert undertook extensive empirical work and economic analysis in this matter, which is reflected in both his report and direct testimony. That empirical work includes, *inter alia*: an analysis of Publisher Defendants' adherence to the price caps specified in the Apple Agency Agreements,[3] an analysis of the increase in Publisher Defendants' average e-book retail prices after switching to the agency

[1] Apple Inc.'s Motion in Limine to Exclude Certain Expert Testimony of Professor Richard Gilbert ("Apple MIL.") at 2.

[2] *Id.*

[3] Gilbert Direct ¶¶ 139-44 and Table 4.

model,[4] and an analysis of Publisher Defendants' declining output growth and declining market share after they increased their average retail prices.[5] To the extent Professor Gilbert's report and testimony refer to facts, those facts are included either because they were considered by Professor Gilbert in forming his expert opinions, or because they help inform and confirm his empirical conclusions.

As for Professor Gilbert's empirical work relating to output, that analysis is based on generally accepted principles of economics, including that economists should attempt to isolate the effects of what they are attempting to study, and should attempt to account for obvious alternative explanations that could cast doubt on the validity of their conclusions. Accordingly, the United States respectfully submits that there is no basis whatsoever to exclude any portion of Professor Gilbert's testimony.

I. PROFESSOR GILBERT'S TESTIMONY IS NOT AN IMPERMISSIBLE FACTUAL NARRATIVE

Despite Apple's broad statements, and given the fact that it is seeking to exclude some of Professor Gilbert's empirical work, Apple cannot legitimately assert that Professor Gilbert "applies no economic analysis."[6] Thus, Apple must acknowledge that its motion *in limine* applies only to a subset of Professor Gilbert's testimony. However, Apple has failed to specify what portion of Professor Gilbert's analysis it finds to be objectionable "factual narrative." That vagueness, by itself, suffices to justify the motion's denial. *See Nat'l Union Fire Ins. Co. v. L.E. Myers Co. Grp.*, 937 F. Supp. 276, 287 (S.D.N.Y. 1996) (when a motion *in limine* lacks "the necessary specificity with respect to the evidence to be excluded" the Court should "reserve judgment on the motion until trial when admission of particular pieces of evidence is in an

[4] *Id*. at ¶¶ 146-50 and Figures 3 and 4 and Table 5.

[5] *Id*. at ¶¶ 68-70 and Figure 2, ¶ 235 and Figure 9.

[6] Apple MIL. at 5.

appropriate factual context."); *see also Baxter Diagnostics, Inc. v. Novatek Med., Inc*., 94 Civ. 5520, 1998 WL 665138, at *3 (S.D.N.Y. Sept. 25, 1998) (denying motions *in limine* to exclude "all 'evidence of Baxter's financial condition'" and "evidence on its punitive damages claim" because the motions *in limine* "lack 'the necessary specificity'").

Apple's lack of specificity is particularly problematic here because, of course, Professor Gilbert references facts at various points in his opinion. That is what he is required to do under the Federal Rules of Civil Procedure. According to Rule 26, a testifying expert *must* include in a written report, *inter alia*, "the facts . . . considered by the witness" in the forming of "all the opinions the witness will express." Fed. R. Civ. P. 26(a)(2)(B)(i), (ii). Indeed, many of the facts that Apple complains Professor Gilbert includes in his report—the bulk of which are not even in dispute[7]—fall within that category.[8]

But beyond that, "[i]t is well settled that an expert is free to offer testimony to provide a background for the case." *U.S. Info. Sys., Inc. v. Int'l Bhd. of Elec. Workers Local Union No. 3, AFL-CIO*, 313 F. Supp. 2d 213, 237 (S.D.N.Y. 2004) (citing *United States v. Mulder*, 273 F.3d 91, 102 (2d Cir. 2001); *United States v. Daly*, 842 F.2d 1380, 1388 (2d Cir. 1988)). And that is what Professor Gilbert also has done. In order to provide a proper context for his empirical analysis, Professor Gilbert has provided the Court with (1) background facts that describe conditions in the e-books market prior to Apple's entry, and (2) a discussion of the negotiation and implementation of the Apple Agency Agreements.

[7]And are, in fact, found in Dr. Murphy's direct testimony, too. *Compare* Murphy Direct ¶ 47 (referencing Amazon's "large share" of e-book sales), *with* Apple MIL. at 5 (criticizing Professor Gilbert for stating that Amazon "had the largest share" of e-book sales) *and compare* Murphy Direct ¶ 59 (referencing Amazon's "$9.99" price for "many new and popular e-books" and its discouraging effect that pricing had on its competitors) *with* Apple MIL. at 5 (criticizing Professor Gilbert for stating that Amazon "priced its ebooks very competitively").

[8] For example, in order to assess the effects on price and output that resulted from Defendants' conspiracy, it was important for Professor Gilbert to understand the state of the market as it existed before the conspiracy came into play. To the extent Professor Gilbert relied on those background facts (which include that Amazon had low prices for e-books and large market share), Professor Gilbert was correct to reference them in his testimony and report.

Simply put, the facts included in Professor Gilbert's report are not intended to be substitutes for economic analyses, nor could they reasonably be considered as such. Rather, they both inform Professor Gilbert's analysis and provide confirmation that his expert opinion comports with the real world.[9] "The exercise of quantifying damages must be supported by an in-depth qualitative analysis of the industry, which should help provide the justification for the methodology and specification chosen. To carry weight, any econometric results will need to be plausible given the known facts about the industry."[10]

Professor Gilbert uses the factual information "to describe the setting in which the parties were operating. From there he applies economic principles," including analyzing the economic incentives created by the Apple Agency Agreements and conducting an empirical analysis, to determine whether Apple's agency model harmed consumers.[11] *See U.S. Info. Sys.*, 313 F. Supp. 2d at 237. Professor Gilbert's "ultimate conclusions are based on the application of standard economic methodology to the facts at hand." *Id*. Accordingly, it was permissible for Professor Gilbert to testify about those facts on which he relied in his analysis. To the extent Apple disagrees with Professor Gilbert's understanding of any factual matter, his disclosure of his understanding allowed Apple to question Professor Gilbert in his deposition and, of course, will allow it to do so again at trial.

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[9] For example, Professor Gilbert's economic analysis found that each Publisher Defendant lost profit in the short term by adopting the agency model. Gilbert Direct ¶¶ 66-83. That is to say, it was against each publisher's unilateral self-interest. Thus, Professor Gilbert concluded that each Publisher Defendant would not have moved to agency unless it expected that its competitors were going to do the same. Professor Gilbert confirmed his conclusion by looking at the factual evidence, which showed that both Apple and Publisher Defendants expected that Publisher Defendants would move Amazon and all other retailers to the agency model.

[10] Peter Davis & Eliana Garcés, QUANTITATIVE TECHNIQUES FOR COMPETITION AND ANTITRUST ANALYSIS 353 (2010).

[11] Professor Gilbert concluded that defendants' actions caused "consumers of e-books [to] have paid substantially higher prices," Gilbert Direct ¶ 17, but Professor Gilbert, like any good economist, was careful to make sure that his economic reasoning was both informed by, and consistent with, the underlying evidence: documents, testimony, and even Defendants' expert reports.

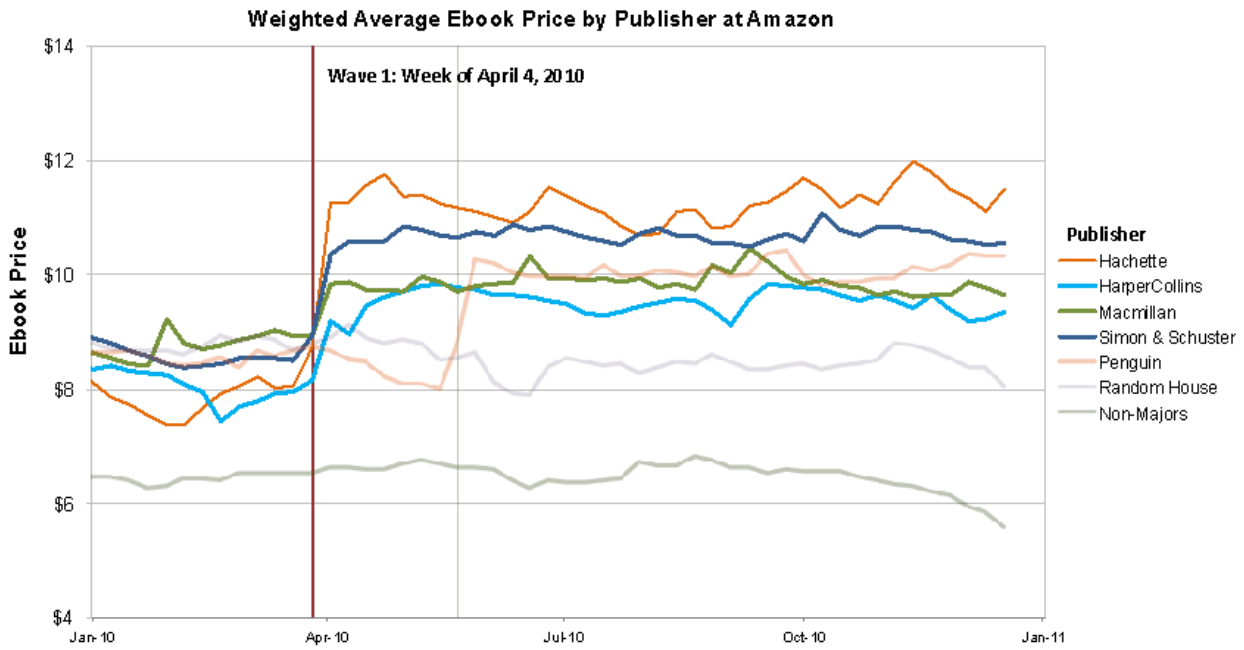
II. PROFESSOR GILBERT'S OUTPUT ANALYSIS IS RELIABLE

As a threshold matter, Apple erroneously contends that under *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 233 (1993), the United States must, even when "some prices rise," offer "proof of an output restriction . . . to sustain a claim of anticompetitive effects."[12] Properly understood, the Court's actual holding was that a plaintiff's failure to show a reduction in output "was *not* dispositive." *Conwood Co. v. U.S. Tobacco Co.*, 290 F.3d 768, 789 (6th Cir. 2002) (emphasis added). The Court in *Brooke Group* was merely observing an economic truism; namely that when prices for normal goods such as e-books increase, all other things being equal, the output of the firms that increased their price will decrease.[13] Here, Professor Gilbert's empirical work properly focused primarily on the price effects arising from the Apple Agency Agreements. Specifically, Professor Gilbert found, as shown below, that the shift to agency caused the average prices of Publisher Defendants' e-books to increase significantly.[14]

[12] Apple MIL. at 7.

[13] That hardly means that an antitrust plaintiff must prove that decrease. To the contrary, if a plaintiff can show a price increase, a decrease in output is assumed. *See General Leaseways, Inc. v. Nat'l Truck Leasing Ass'n*, 744 F.2d 588, 594-95 (7th Cir. 1984). Nor is the fact that output overall continued to increase damaging to Professor Gilbert's conclusions. *See Fleischman v. Albany Med. Ctr.*, 728 F. Supp. 2d 130, 155 (N.D.N.Y. 2010) (expert opinion that information exchanges softened wage competition for nurses in area hospitals not contradicted by the fact that overall compensation continued to rise).

[14] Gilbert Direct ¶¶ 146-53.



Gilbert Direct Figure 3: The average per unit e-book prices at Amazon of each First Wave Agency Publisher increased significantly when it switched to agency

Professor Gilbert also found that, as standard economics predicts, this price increase coincided with a reduction in Publisher Defendants' unit sales and an increase in non-defendant publishers' unit sales, resulting in an immediate net decrease in total sales across both sets of titles. This is sufficient evidence of anticompetitive effects arising from the conspiracy.

Apple's motion does not directly contest Professor Gilbert's finding that prices increased. Instead, it only critiques Professor Gilbert's findings regarding the net output decrease that accompanied the price increases, which is a minor point in his analysis. To the extent relevant, Apple's attacks are misleading and factually incorrect. Though nominally expressed as three or

four separate flaws, the essence of each is that Apple disagrees with the window Professor Gilbert used to analyze the effects of Apple's conspiracy with Publisher Defendants.[15]

Professor Gilbert's decision to select a short time window was well-considered and is consistent with generally accepted economic principles. Far from being "litigation-driven," Professor Gilbert's use of a short window allowed him to isolate the direct effects of the conspiracy, all of which occurred within a few days, while decreasing the "noise" from other factors that may have affected e-book prices and sales, including the rapid maturation of the industry and any life-cycle trend. Thus, Apple's attack that Professor Gilbert fails to account for the sales of a particular title declining over time is incorrect.[16]

Apple also misleadingly contends that Professor Gilbert's analysis regarding output "is based on 0.4% of the sales of trade e-books *during the period April 2010 through March 2012*," to suggest that Professor Gilbert did not show harm to the whole market.[17] This assertion is irrelevant. Professor Gilbert did not analyze output over Apple's arbitrarily selected time period.[18] For the window in which Professor Gilbert actually *did* analyze output, he looked at the sales of all trade e-books sold at the beginning and end of his before-and-after study.

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[15] Notably, and notwithstanding Apple's contention to the contrary, this does not amount to an attack on Professor Gilbert's methodology. Professor Gilbert used a "before-and-after" approach, which is generally accepted in economics and validated by courts if the expert accounts for differences in market conditions across the compared periods. *See, e.g.*, *Sun Microsystems Inc. v. Hynix Semiconductor Inc.*, 608 F. Supp. 2d 1166, 1208 (N.D. Cal. 2009) (citing *Pacific Coast Agricultural Export Ass'n v. Sunkist Growers, Inc.*, 526 F.2d 1196 (9th Cir. 1975)).

[16] Apple MIL. at 9-10. Moreover, the principal purpose of this particular analysis was to test whether agency increased the output of those who adopted agency relative to those who did not. When agency contracts and MFNs are procompetitive, they generally keep prices low or increase output or shares of the adopting firms. Here, the answer is clear: Not only did the average prices of those who adopted agency rise, but their output also fell relative to those who did not adopt agency—a result Apple has not contested. Gilbert Direct ¶¶ 67-70, 128, 234-38.

[17] Apple MIL. at 9 (emphasis added).

[18] Apple's motion includes a citation to "[Burtis trial affidavit]" for this point. *Id*. at 9. Dr. Burtis's affidavit makes no reference whatsoever to the point being cited.

In contrast, Apple's expert Dr. Burtis "offered no rationale for her choice of such long time periods, other than it happened to be all the data she received."[19] Dr. Burtis's failure to be deliberate in selecting an appropriate window to analyze the conspiracy renders her analysis unreliable, because any observed effect may be driven by factors other than the move to agency.[20] These factors include the upward trend in e-book growth as more consumers adopt e-reading, a changing mix of titles, and even the peak book-buying holiday season. For this reason, so-called "long horizon" studies like the one conducted by Dr. Burtis "require extreme caution."[21] Dr. Burtis failed to show that caution here.

Finally, when Apple attacks Professor Gilbert's opinion regarding industry-wide growth in output, its argument actually applies with force to Dr. Burtis's opinions. In her initial report, Dr. Burtis stated that "[s]ales of eBooks increased dramatically during the post-agency period—a result that is inconsistent with allegations that the agency agreements had an anticompetitive effect."[22] But as Professor Gilbert points out in his testimony:

> nowhere did Dr. Burtis show or even argue that the increase in sales of e-books is in any way attributable to defendants' adoption of the Apple Agency Agreements. In particular, Dr. Burtis did not isolate any increases in e-reading caused by the launch of the iPad (as opposed to the iBookstore) or the continuation of the pre-existing trend, and instead implicitly attributes those increases to the adoption of the Apple Agency Agreements.[23]

[19] Gilbert Direct ¶ 175.

[20] *Id*. at ¶¶ 175-77. Apple's apparent awareness that external factors affect price and output over time makes Dr. Burtis' failure to even attempt to control for such factors through regression or some other method all the more inexplicable. *See* Plaintiffs' Motion *in Limine* re: Dr. Burtis at 4.

[21] S.P. Kothari & Jerold B. Warner, *Econometrics of Event Studies*, in HANDBOOK OF CORPORATE FINANCE: EMPIRICAL CORPORATE FINANCE, Vol. 1, at 8 (B. Espen Eckbo, ed., 2007).

[22] Burtis Initial Report ¶ 27.

[23] Gilbert Direct ¶ 228.

That is, Dr. Burtis "offer[ed] no opinion that the alleged relevant market would have expanded at a [lesser] rate but-for the Apple agency agreements."[24] Thus, far from "admitting" that one could not isolate the relationship between the adoption of agency and the industry's growth rate, Professor Gilbert was *criticizing* Dr. Burtis's analysis because it did not account for the general growth trend. Apparently, Apple now agrees with Professor Gilbert's criticism.

Professor Gilbert's only conclusion related to the industry growth rate was that Dr. Burtis's opinion was not only irrelevant, but also inaccurate. Specifically, in an analysis using Dr. Burtis's data, Professor Gilbert found that the number of paid e-book purchases of all titles at all e-retailers grew more slowly in the year following the switch to agency than during the year prior to agency.[25] By failing to account for industry sales growth over time, Dr. Burtis underestimates the true competitive harm caused by the conspiracy and falsely attributes the natural growth in e-book sales to the agency agreements. Apple itself concedes that output was growing "at very high rates" both before and after the adoption of the Apple Agency Agreements, so it is inexcusable that in Dr. Burtis's analysis this fact was ignored.[26]

CONCLUSION

For the foregoing reasons, the United States respectfully requests that Apple's motion *in limine* be denied.

[24] Apple MIL. at 10.

[25] Gilbert Direct ¶ 233.

[26] Apple MIL. at 9.

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Respectfully submitted,

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