MERGER ANTITRUST LAW

Unit 18: Penguin/Simon & Schuster

Class 26

Professor Dale Collins
Georgetown University Law Center
Fall 2022

Table of Contents

Loose Ends

Penguin Random House/ Simon & Schuster

BERTELSMANN

Press Release

Press Release | Gütersloh/New York, 11/25/2020

Bertelsmann Strengthens Global Content Businesses with Acquisition of Simon & Schuster

- **Penguin Random House buys global publisher for $2.175 billion**
- **Acquisition strengthens position in Group's second-largest market, the U.S**
- **Simon & Schuster is the publishing home to well-known authors such as Hillary Clinton, John Irving, Stephen King, and Bob Woodward**
- **Transaction expected to close during 2021**

Bertelsmann, the international media, services, and education company, is further expanding its global content businesses with the acquisition of the publishing house Simon & Schuster. Bertelsmann's global trade book publishing group, Penguin Random House, is purchasing the book publishing business from the media company ViacomCBS for $2.175 billion. Simon & Schuster strengthens Bertelsmann's footprint globally, and particular in the U.S., its second-largest market. Simon & Schuster employs around 1,500 people worldwide and generated revenues of $814 million in 2019. It publishes works from well-known authors and public figures including Hillary Clinton, John Irving, Stephen King, and Bob Woodward. The transaction is subject to regulatory approvals and is expected to close during 2021. Bertelsmann will pay the purchase price in cash from existing liquid funds. Simon & Schuster will continue to be managed as a separate publishing unit under the Penguin Random House umbrella. Jonathan Karp, President & CEO of Simon & Schuster, and Dennis Eulau, COO and CFO, will continue at the helm of the publishing house.

Thomas Rabe, Chairman & CEO of Bertelsmann, said: "Following the full acquisition of Penguin Random House in April this year, this purchase marks another strategic milestone in strengthening our global content businesses, which include Penguin Random House, the Fremantle TV production business, and the BMG music division. The book business has been part of Bertelsmann's identity since the founding of C. Bertelsmann Verlag more than 185 years ago and has lost none of its appeal to this day. Bertelsmann continues to be one of the world's leading creative companies with annual investments in content of around €6 billion.

"Bertelsmann will finance the acquisition of Simon & Schuster from existing cash resources. External borrowing is not necessary, thanks partly to the overall positive business development since the summer and the already completed sale of various businesses, investments and real-estate properties."

Markus Dohle, CEO Penguin Random House and a member of the Bertelsmann Executive Board, added: "Simon & Schuster is an extremely well-managed and extraordinarily attractive company with world-renowned authors, 2,000 new publications annually, and a catalog of 35,000 titles. We are very proud to welcome this esteemed company, founded in 1924, to our global publishing community. We share the same passion for books and reading and will work together to give our authors the greatest possible access to readers worldwide. Penguin Random House empowers its 320 publishers around the world with maximum creative and entrepreneurial freedom and will, of course, extend this to our new colleagues at Simon & Schuster."

Penguin Random House, comprising more than 320 imprints, employs approximately 10,000 people worldwide on six continents. The group publishes around 15,000 new books a year. On November 17, 2020, the first part of former U.S. President Barack Obama's memoirs, "A Promised Land" was published to great success. The biggest-selling novel in the first half of 2020 was “Where the Crawdads Sing” by Delia Owens, which sold more than 1.6 million copies; this brings overall sales of the title in North America alone to more than 6.5 million copies across all formats since its publication in 2018. Michelle Obama’s memoir, published in November 2018, has sold 15 million copies to date.

J.P. Morgan Securities LLC acted as financial advisor, Davis Polk & Wardwell LLP as legal counsel and Arnold & Porter as regulatory counsel to Bertelsmann on the transaction.

Chronicle

1835
Carl Bertelsmann, a printer and bookbinder, founds C. Bertelsmann Verlag in 1835. The program during the first 100 years of the publisher’s history was dominated by the Protestant Christian tradition. The publishing program was gradually expanded to include philology, history and youth literature, as well as mission literature.

1928
Bertelsmann launches its fiction publishing program with “narrative literature” in Protestant magazines.

1933-1945
The publishing house’s conservative Christian tradition is increasingly linked with Nationalist Socialist ideology in its program and corporate culture. After the start of World War II, the publisher – as the largest supplier of books to the German Armed Forces – generates profits primarily with the sale of “Feldpost” army editions. A lawsuit concerning illegal procurement of paper stocks, and the mobilization of the entire German economy, led to the closure of C. Bertelsmann Verlag in 1944. Starting in 1999, an Independent Historical Commission under the direction of historian Saul Friedländer researched Bertelsmann’s history during the period of National Socialism. Its report on “Bertelsmann in the Third Reich” was published in 2002 by C. Bertelsmann Verlag.

from 1950
Bertelsmann founds the Lesering book club. Its success marks the beginning of a new era in the company’s history and creates the foundation for the company’s rise to become the global media, services and education group it is today.

1968
Eleven separate Bertelsmann publishing companies are organizationally grouped into Verlagsgruppe Bertelsmann (from 2001: Verlagsgruppe Random House).

1977
Bertelsmann considerably expands its book business by taking over Goldmann Verlag and acquiring stakes in the publishers Plaza y Janes (Spain) and Bantam Books (U.S.).

1986
Bertelsmann buys the American publisher Doubleday and a year later groups its U.S. publishers into the Bantam Doubleday Dell Publishing Group.

1998
Bertelsmann acquires the American publisher Random House, with an author roster including Truman Capote, Philip Roth, John Le Carré, Michael Crichton, Salman Rushdie, Anne Rice, and Margaret Atwood. The group is merged with Bantam Doubleday Dell. From 2001, Random House becomes the umbrella for Bertelsmann’s global book publishing activities.

2013
On July 1, Bertelsmann and Pearson combine their book publishing businesses – Random House and Penguin Group – into the world’s biggest trade publishing group. Bertelsmann is the majority owner of the merged company Penguin Random House, with a 53-percent stake, while Pearson owns 47 percent. The group’s various bestsellers include: “50 Shades of Gray,” “The Girl on the Train,” and the “Game of Thrones” series. Penguin Random House author Alice Munro wins the 2013 Nobel Prize in Literature. In all, more than 70 Penguin Random House authors are Nobel laureates.

2017
Bertelsmann acquires another 22 percent of the shares in Penguin Random from co-shareholder Pearson, to achieve its strategic target holding in a global trade publishing group.

2020
Bertelsmann increases its stake in Penguin Random House to 100 percent and becomes sole owner of the world’s largest trade publishing group.

Bertelsmann signs a deal to buy Simon & Schuster and plans to integrate it under the Penguin Random House umbrella. Upon closing the book publishing business will become Bertelsmann’s second-largest division after RTL Group.

About Bertelsmann
Bertelsmann is a media, services and education company that operates in about 50 countries around the world. It includes the broadcaster RTL Group,

the trade book publisher Penguin Random House, the magazine publisher Gruner + Jahr, the music company BMG, the service provider Arvato, the Bertelsmann Printing Group, the Bertelsmann Education Group and Bertelsmann Investments, an international network of funds. The company has 126,000 employees and generated revenues of €18.0 billion in the 2019 financial year. Bertelsmann stands for creativity and entrepreneurship. This combination promotes first-class media content and innovative service solutions that inspire customers around the world. Bertelsmann aspires to achieve climate neutrality by 2030.

About Penguin Random House
Penguin Random House, the world's largest trade book publisher, is dedicated to its mission of nourishing a universal passion for reading by connecting authors and their writing with readers everywhere. The company, which employs more than 10,000 people globally, was formed on July 1, 2013, by Bertelsmann and Pearson. As of April 1, 2020, Bertelsmann is full owner of the company. With more than 300 imprints and brands on six continents, Penguin Random House comprises adult and children's fiction and nonfiction print and digital English- German- and Spanish-language trade book publishing businesses in more than 20 countries worldwide. With over 15,000 new titles, and more than 600 million print, audio and eBooks sold annually, Penguin Random House's publishing lists include more than 80 Nobel Prize laureates and hundreds of the world's most widely read authors.

About Simon & Schuster
Simon & Schuster, a ViacomCBS Company, is a global leader in general interest publishing, dedicated to providing the best in fiction and nonfiction for readers of all ages, and in all printed, digital and audio formats. Its distinguished roster of authors includes many of the world's most popular and widely recognized writers, and winners of the most prestigious literary honors and awards. It is home to numerous well-known imprints and divisions such as Simon & Schuster, Scribner, Atria Books, Gallery Books, Adams Media, Simon & Schuster Children's Publishing and Simon & Schuster Audio and international companies in Australia, Canada, India and the United Kingdom, and proudly brings the works of its authors to readers in more than 200 countries and territories. For more information visit website at **www.simonandschuster.com (http://www.simonandschuster.com)**

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Acquisition of Simon & Schuster

November 25, 2020

BERTELSMANN

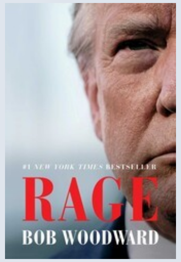
Overview –

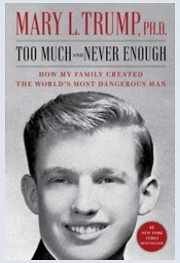
Simon & Schuster is an attractive company in a growing industry

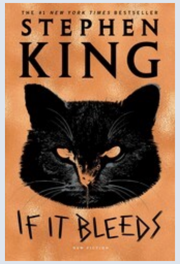
Simon & Schuster at a Glance

- **Leading U.S. trade publisher** with ~1,500 employees
- **Highly profitable** with **revenues** of **US$ 814m** (2019)
- **Well-known authors**, **strong rights catalog** and **highly talented publishing team**

Bestsellers in 2020

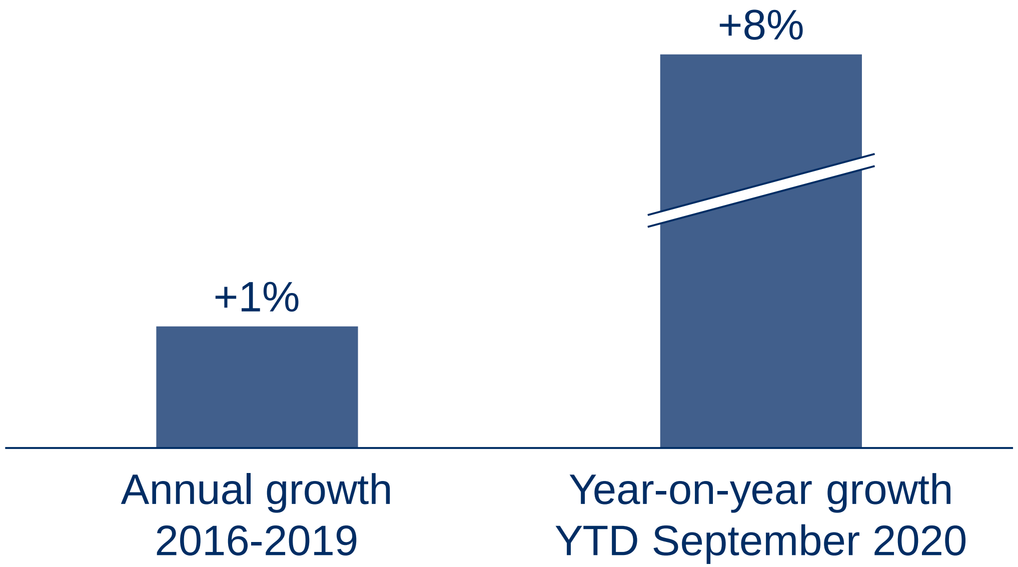






57	18	9
Pulitzer Prizes	National Book Awards	Grammy Awards

Development of U.S. trade publisher revenues[1)]



- **Book business resilient** and **growing**
- **Continued future growth** expected (e.g., due to growing target audience and incremental growth in digital audiobooks)

1) Source: AAP Statshot

Strategic Rationale –
Consistent with Bertelsmann's Strategic Goals

Bertelsmann's strategic goals (selected)	**Strategic fit with Simon & Schuster**
Expand global content business	• **Penguin Random House main pillar** of Bertelsmann's **global content business** alongside BMG and Fremantle • **Significant expansion** of PRH's **content portfolio**
Expand U.S. business	• **Simon & Schuster** with **strong U.S. focus** (85% of revenues) • Further **regional diversification** of **Bertelsmann's portfolio**

Penguin Random House

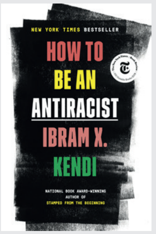
Headquarters: New York | **Parent company:** Bertelsmann (100 percent)

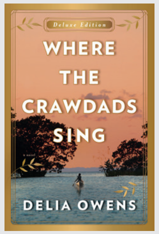
>320	imprints on six continents
>15,000	new publications worldwide per year
>10,000	employees in 20 countries
>80	Nobel Prize laureates

Most spectacular book deal of recent years

Acquisition of the worldwide rights to the memoirs of former US President **Barack Obama** ("A Promised Land") and former First Lady **Michelle Obama** ("Becoming").

Bestseller 2020





Well-known authors

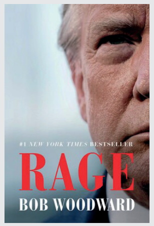
Margaret Atwood, Ken Follett, Malcolm Gladwell, John Grisham, Khaled Hosseini, EL James, Toni Morrison, Sir Ahmed Salman Rushdie, Danielle Steel

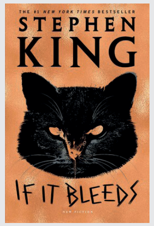
Simon & Schuster

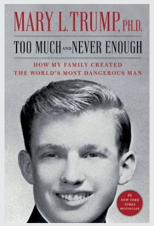
Headquarters: New York | **Parent company:** ViacomCBS Corporation

30	imprints on four continents
~ 2,000	new publications worldwide per year
~ 1,500	employees in 5 countries
57	Pulitzer Prizes

Bestseller 2020







Well-known authors

Mary Higgins Clark, Hillary Rodham Clinton, Janet Evanovich, Stephen King, John Irving, Howard Stern, Jesmyn Ward, Ruth Ware, Bob Woodward

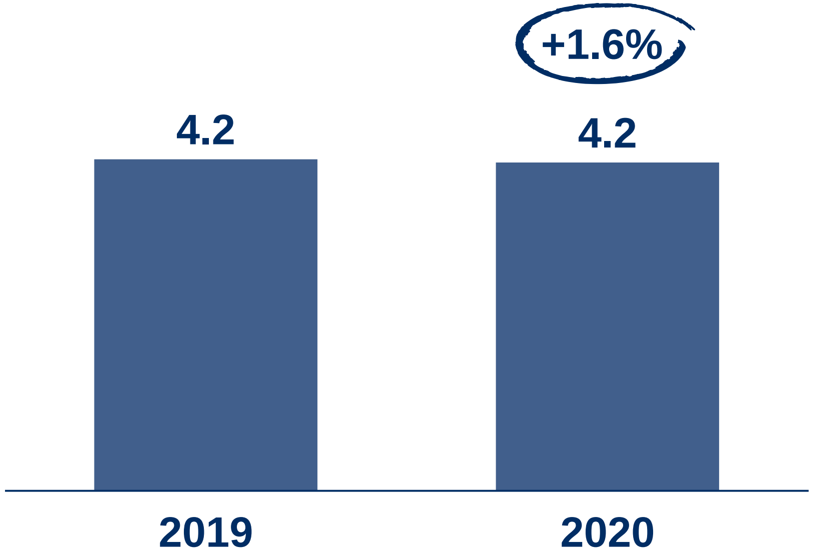
Financing of the Transaction –
Unproblematic due to positive business performance and high liquidity

Business Performance Bertelsmann

Q3, in € billions

Organic growth

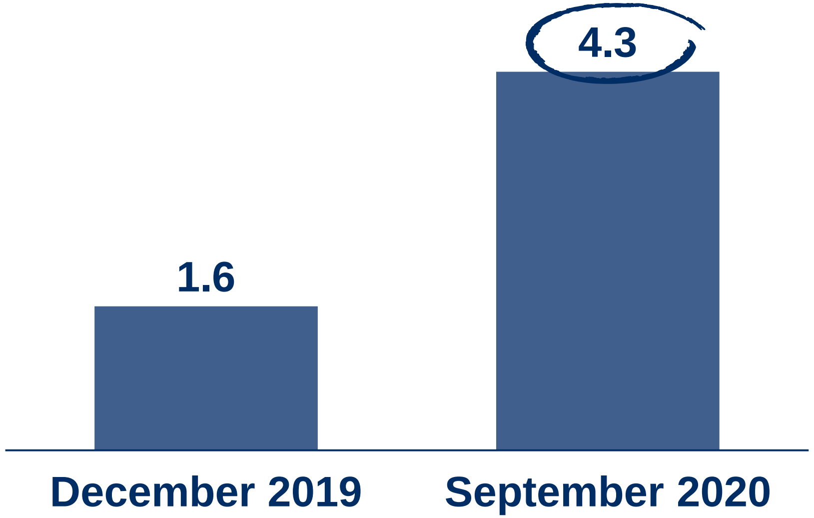
Revenues



- **Diversified business portfolio**
- **High share** of **digital business models**
- Most recently **significant recovery in TV ad sales**
- **Confidence** for **4th quarter**

Liquidity Situation Bertelsmann

Liquid funds,
in € billions



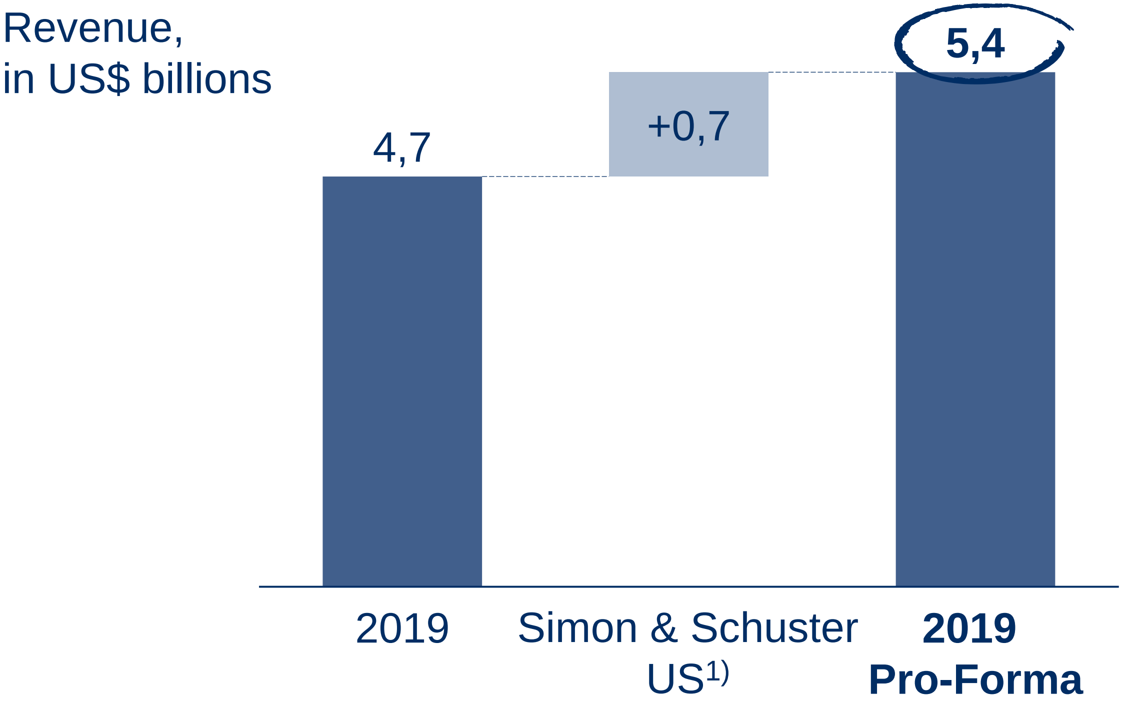
- **Massive** Covid **countermeasures**
- **Financing measures** to secure liquidity
- **Financing** of **transaction** from **existing liquid funds possible**

Bertelsmann in the U.S. –
Nearly all divisions have operations in the U.S.; Revenues > US$ 5 bn with Simon & Schuster

Bertelsmann divisions with US presence

- RTL Group
- Penguin Random House
- BMG
- arvato Bertelsmann
- Bertelsmann Printing Group
- Bertelsmann Education Group
- BI Bertelsmann Investments

Bertelsmann U.S. Key Figures



	2019	Simon & Schuster US[1]	2019 Pro-Forma
Employees, in thousands	9,9	~1,2	**11,1**

1) Revenue and employee figures relate to Simon & Schuster's U.S. business only; 85% of total revenues in 2019 (814 Mio. US$)

JUSTICE NEWS

Department of Justice

Office of Public Affairs

FOR IMMEDIATE RELEASE Tuesday, November 2, 2021

Justice Department Sues to Block Penguin Random House's Acquisition of Rival Publisher Simon & Schuster

Merger Would Create Publishing Behemoth, Harming Authors and Consumers

The U.S. Department of Justice filed a civil antitrust lawsuit today to block Penguin Random House's proposed acquisition of its close competitor, Simon & Schuster. As alleged in the complaint filed in the U.S. District Court for the District of Columbia, this acquisition would enable Penguin Random House, which is already the largest book publisher in the world, to exert outsized influence over which books are published in the United States and how much authors are paid for their work.

"The complaint filed today to ensure fair competition in the U.S. publishing industry is the latest demonstration of the Justice Department's commitment to pursuing economic opportunity and fairness through antitrust enforcement," said Attorney General Merrick B. Garland.

"Books have shaped American public life throughout our nation's history, and authors are the lifeblood of book publishing in America. But just five publishers control the U.S. publishing industry," the Attorney General continued. "If the world's largest book publisher is permitted to acquire one of its biggest rivals, it will have unprecedented control over this important industry. American authors and consumers will pay the price of this anticompetitive merger – lower advances for authors and ultimately fewer books and less variety for consumers."

"In stopping Penguin Random House from extending its control of the U.S. publishing market, this lawsuit will prevent further consolidation in an industry that has a history of collusion," said Acting Assistant Attorney General Richard A. Powers of the Justice Department's Antitrust Division. "I want to thank the Attorney General and senior leadership of the department for their support of antitrust enforcement."

As described in the complaint, publishers compete to acquire manuscripts, which they edit, package, market, distribute and sell as books. Publishers pay authors advances for the rights to publish their books. In most cases, the advance represents an author's total compensation for their work.

The publishing industry is already highly concentrated, as the complaint details. Just five publishers, known as the "Big Five," are regularly able to offer high advances and extensive marketing and editorial support, making them the best option for authors who want to publish a top-selling book. Most authors aspire to write the next bestseller and selling their rights to the Big Five offers the best chance to do so.

While smaller publishers occasionally win the publishing rights to anticipated top-selling books, they lack the financial resources to regularly pay the high advances required and absorb the financial losses if a book does not meet sales expectations. Today, Penguin Random House, the world's largest publisher, and Simon & Schuster, the fourth largest in the United States, compete head-to-head to acquire manuscripts by offering higher advances, better services and more favorable contract terms to authors. However, as the complaint alleges, the proposed merger would eliminate this important competition, resulting in lower advances for authors and ultimately fewer books and less variety for consumers.

The complaint alleges that the acquisition of Simon & Schuster for $2.175 billion would put Penguin Random House in control of close to half the market for acquiring publishing rights to anticipated top-selling books, leaving hundreds of individual authors with fewer options and less leverage. According to its own documents as described in the complaint, Penguin Random House views the U.S. publishing market as an "oligopoly" and its acquisition of Simon & Schuster is intended to "cement" its position as the dominant publisher in the United States.

Courts have long recognized that the antitrust laws are designed to protect both buyers and sellers of products and services, including, as relevant here, authors who rely on competition between the major publishers to ensure they are fairly compensated for their work. As the complaint makes clear, this merger will cause harm to American workers, in this case authors, through consolidation among buyers – a fact pattern referred to as "monopsony."

The Antitrust Division's Horizontal Merger Guidelines lay out a straightforward framework to analyze monopsony cases, and under those guidelines this transaction is presumptively anticompetitive. Simply put, if Penguin Random House acquires Simon & Schuster, the two publishers will stop competing against each other. As a result, authors will be paid less for their work. Authors who are paid less write less, which, in turn, means that the quantity and variety of books diminishes too.

Penguin Random House LLC is a subsidiary of Bertelsmann SE & Co. KGaA and is headquartered in New York, New York. Penguin Random House publishes 2,000 new trade books in the United States annually. In 2019, Penguin Random House reported revenues of $2.4 billion from U.S. publishing.

UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF COLUMBIA

UNITED STATES OF AMERICA
U.S. Department of Justice
Antitrust Division
450 Fifth Street, NW, Suite 4000
Washington, DC 20530,

Plaintiff,

v.

BERTELSMANN SE & CO. KGaA
Carl-Bertelsmann-Strasse 270
33311 Gütersloh, Germany,

PENGUIN RANDOM HOUSE, LLC
1745 Broadway
New York, NY 10019,

VIACOMCBS, INC.
1515 Broadway
New York, NY 10036,

and

SIMON & SCHUSTER, INC.
1230 Avenue of the Americas
New York, NY 10020

Defendants.

COMPLAINT

The United States of America brings this civil action to stop Penguin Random House, LLC—the world's largest book publisher—from buying its publishing rival, Simon & Schuster, Inc. If Defendants' proposed merger is allowed to proceed, Penguin Random

House would be, by far, the largest book publisher in the United States, towering over its rivals. The merger would give Penguin Random House outsized influence over who and what is published, and how much authors are paid for their work. The deal, which was arranged by the two publishers' parent companies, Bertelsmann SE & Co. KGaA, ("Bertelsmann") and ViacomCBS, Inc. ("ViacomCBS"), would likely harm competition in the publishing industry and should be blocked. The United States alleges as follows:

INTRODUCTION

1. Authors are the lifeblood of book publishing. Without authors, there would be no stories; no poetry; no biographies; no written discourse on history, arts, culture, society, or politics. In the words of Penguin Random House's U.S. CEO, "[B]ooks have the power to sustain us, particularly in challenging times . . ." Penguin Random House's Global CEO put it more simply, "Books matter . . ."

2. Penguin Random House's proposed acquisition of Simon & Schuster would result in substantial harm to authors, particularly authors of anticipated top-selling books. Today, Penguin Random House and Simon & Schuster compete vigorously to acquire publishing rights from authors and provide publishing services to those authors. This competition has resulted in authors earning more for their publishing rights in the form of advances (*i.e.*, upfront payments made to authors for the rights to publish their works), and receiving better editorial, marketing, and other services that are critical to the success of their books. In 2020 alone, publishers paid authors over $1 billion in advances. Authors rely on these advances to fund their writing and pay their bills.

3. Penguin Random House is the world's largest book publisher, and Simon & Schuster is the fourth-largest U.S. book publisher. Together their U.S. revenues would be

twice that of their next closest competitor. Indeed, one of Penguin Random House's strategic goals for the merger is to "cement Penguin Random House as #1 in the U.S."

4. Penguin Random House and Simon & Schuster are two of what the industry calls the "Big Five" U.S. publishers.[1] The Big Five and their predecessors have long dominated the U.S. publishing market. In evaluating a potential acquisition of Simon & Schuster, a Bertelsmann board presentation characterized the U.S. publishing industry as an "oligopoly" of Penguin Random House and "only 4 further large publishers."

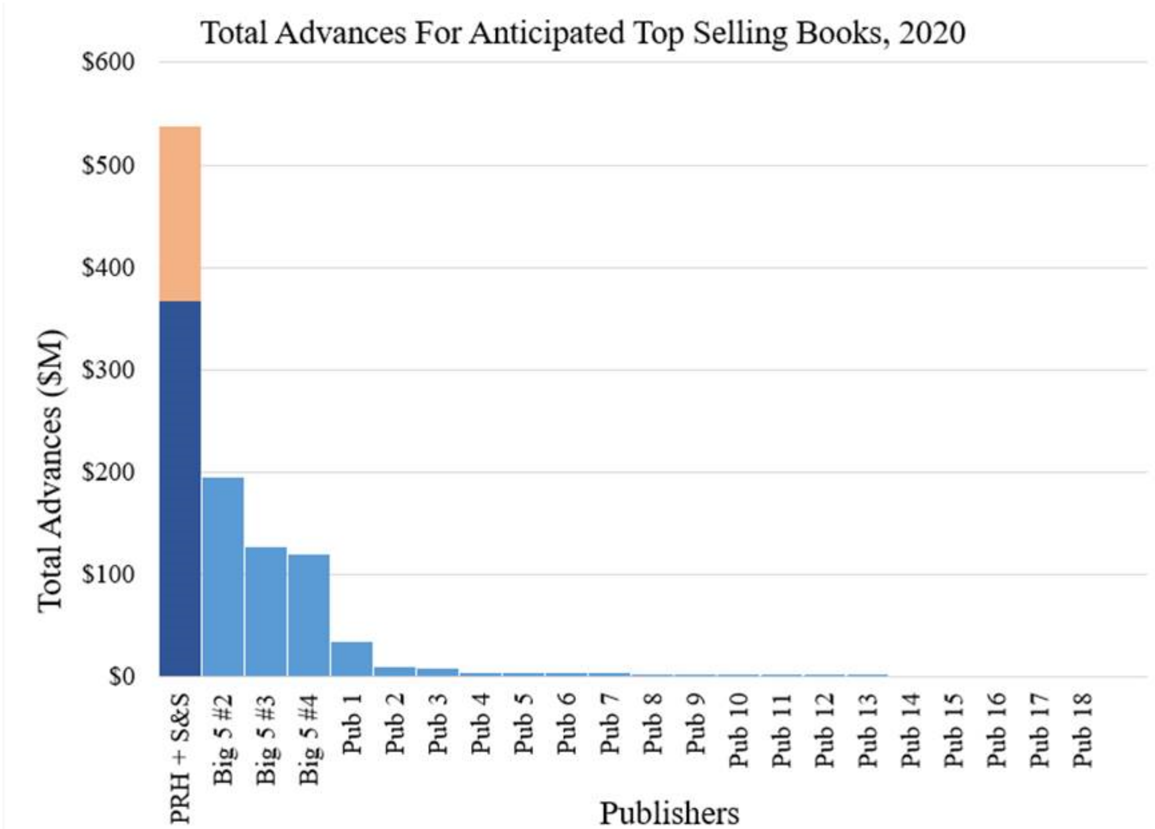
5. Publishing is a risky business. Only a fraction of books published become commercially successful. Publishers pay significant advances to authors whose books they expect will have commercial success. In most cases, the advance represents an author's total compensation. One reason the Big Five are able to offer authors higher advances than smaller publishers is because they can spread the costs—and risks—of their investment over a larger number of books and authors. They also are able to offer authors the extensive editorial, production, marketing, and publicity support generally needed to produce a top-selling book, and the sales and distribution networks necessary to place books into readers' hands.

6. Publishers other than the Big Five cannot regularly pay the high advances and provide the unique bundle of services needed to secure the publishing rights to anticipated top-selling books and maximize their chances of becoming commercially successful. Simon & Schuster's late CEO likened non-Big Five publishers to "farm teams for authors" from

[1] The other three Big Five publishers are HarperCollins Publishers (which recently acquired Houghton Mifflin Harcourt's trade publishing business for $349 million), Hachette Book Group (which recently acquired Workman Publishing, one of the largest independently-owned publishers in the U.S.), and Macmillan Publishing Group, LLC.

which the Big Five could cherry pick talent. In contrast, she described the other Big Five publishers as "our biggest competitors, especially for books by already bestselling authors and celebrities, since they are the most likely to come up with the high advance payments required and are known for their strong editorial and publishing skills."

7. If consummated, this merger would likely result in substantial harm to authors of anticipated top-selling books and ultimately, consumers. Penguin Random House would control close to half of the market for the acquisition of publishing rights to anticipated top-selling books. Penguin Random House's next largest competitor would be less than half its size. Post-merger, the two largest publishers would collectively control more than two-thirds of this market, leaving hundreds of authors with fewer alternatives and less leverage. As illustrated by the chart below, when measured by total advances paid to authors for rights to anticipated top-selling books, the combined Penguin Random House-Simon & Schuster (shown in dark blue and orange) would far outstrip the remaining Big Five publishers and the largest independent publishers (shown in lighter blue), and enjoy substantial market power in its negotiations with authors:



8. Penguin Random House and Simon & Schuster compete head-to-head to acquire publishing rights to hundreds of books every year, and this competition has resulted in substantial benefits for authors of anticipated top-selling books. Penguin Random House and Simon & Schuster are frequently invited by agents to bid in auctions for the rights to these books, and they are often the final two bidders. Competition between Penguin Random House and Simon & Schuster has resulted in higher advances, better services, and more favorable contract terms for authors.

9. The proposed merger would eliminate this head-to-head competition, enabling the merged firm to pay less and extract more from authors who often work for years at their craft before producing a book. As a senior Penguin Random House executive remarked to a colleague: "I would not want to be a big author at Simon & Schuster now . . ." The colleague

responded, "I agree. Especially when the price tag [for acquiring Simon & Schuster] is going to be so high." By harming authors, the merger is also likely to harm consumers. Penguin Random House's Global CEO has recognized the principle that reducing author pay means "[f]ewer authors will be able to make a living from writing" which, in turn, "will have an impact on the output." By reducing author pay, this merger would make it harder for authors to earn a living by writing books, which would, in turn, lead to a reduction in the quantity and variety of books published.

10. There is no reason to accept the harm to competition threatened by this merger. Although Defendants have publicly suggested that the merger is necessary to create a stronger counterweight to Amazon, Penguin Random House's Global CEO privately admitted that he "never, never bought into that argument" and that one "[g]oal" after the merger is to become an "[e]xceptional partner" to Amazon.

11. Penguin Random House and Simon & Schuster both recognized that a merger of their companies would give rise to substantial antitrust risk. When Simon & Schuster announced that it was up for sale in March 2020, its current CEO wrote to one of its best-selling authors: "I'm pretty sure that the Department of Justice wouldn't allow Penguin Random House to buy us, but that's assuming we still have a Department of Justice." That same month, the Chairman of Bertelsmann, Penguin Random House's parent, acknowledged that Penguin Random House posed greater "antitrust risks" than any other potential buyer of Simon & Schuster. As a consequence of that risk, Bertelsmann understood that it would have to pay a significant premium over other bidders to acquire Simon & Schuster.

12. Authors and consumers should not be asked to bear the risk and suffer the harm from this anticompetitive merger. For the reasons set forth in this Complaint, Penguin

Random House's proposed acquisition of Simon & Schuster is likely to substantially lessen competition in violation of Section 7 of the Clayton Act and should be enjoined.

JURISDICTION AND VENUE

13. The United States brings this action under Section 15 of the Clayton Act, as amended, 15 U.S.C § 25, to prevent and restrain Defendants from violating Section 7 of the Clayton Act, 15 U.S.C. § 18. This Court has subject matter jurisdiction over this action under Section 15 of the Clayton Act, 15 U.S.C § 25, and 28 U.S.C. §§ 1331, 1337(a), and 1345.

14. Defendants Penguin Random House and Simon & Schuster are engaged in interstate commerce and in activities substantially affecting interstate commerce. Penguin Random House and Simon & Schuster acquire publishing rights from authors and provide publishing services, including editing, marketing, sales, and distribution of general trade books, to authors throughout the United States.

15. This Court has personal jurisdiction over each Defendant. Bertelsmann and ViacomCBS have consented to personal jurisdiction in this District. Penguin Random House and Simon & Schuster also are corporations that transact business within this District through, among other things, their acquisition of content from and provision of publishing services to authors.

16. Venue is proper in this District under Section 12 of the Clayton Act, 15 U.S.C. § 22, and 28 U.S.C. § 1391.

DEFENDANTS AND THE PROPOSED TRANSACTION

17. Bertelsmann is an international media and services company, headquartered in Gütersloh, Germany. Bertelsmann has numerous subsidiaries, including Penguin Random House and the Bertelsmann Printing Group, a major supplier of book printing services in the United States.

18. Penguin Random House is headquartered in New York, New York. Penguin Random House was formed from the 2013 merger of Penguin and Random House, which were founded in 1935 and 1927, respectively. Penguin Random House has more than 90 U.S. imprints (a trade or brand name for a specific group of editors, such as Doubleday), across seven publishing groups. Penguin Random House is the largest U.S. trade book publisher. It publishes over 2,000 new titles every year in the U.S. In addition to publishing, Penguin Random House sells distribution services to third-party publishers. In 2020, Penguin Random House earned over $2.4 billion in U.S. publishing revenues.

19. ViacomCBS is an international media and entertainment company, headquartered in New York, New York. ViacomCBS's assets include the Paramount film and television studios, the CBS television network, cable networks, streaming services, and Simon & Schuster.

20. Simon & Schuster, headquartered in New York, New York, is a wholly-owned subsidiary of ViacomCBS. Founded in 1924, Simon & Schuster is the fourth-largest U.S. trade book publisher. It has over 30 U.S. imprints across three publishing groups and publishes over 1,000 new titles annually in the U.S. In 2020, Simon & Schuster earned over $760 million in U.S. publishing revenues.

21. On November 25, 2020, Bertelsmann and ViacomCBS announced that Penguin Random House would acquire Simon & Schuster from ViacomCBS in an all-cash deal valued at approximately $2.175 billion.

BACKGROUND

A. U.S. General Trade Book Publishing

22. The term "general trade books" (hereinafter "books") is widely used in the publishing industry and refers to books that are published for wide public consumption, including both fiction and a variety of non-fiction such as biographies, cookbooks, travel guides, and self-help books. It does not include, for example, academic texts or professional manuals. Bringing a book to market in the United States requires the participation of many different entities, including authors and their agents, publishers, printers, distributors, wholesalers, retailers, and ultimately, readers.

23. Book publishing is a collaborative effort between authors and publishers. An author writes a manuscript or proposal for a book and generally hires an agent to solicit competing bids from publishers and negotiate a license for the book's publishing rights with the winning bidder. The licenses obtained by publishers generally include the right to publish a book in various formats (print, e-book, audiobook) within a particular geographic area. Publishers compete for these rights on a number of different dimensions. In addition to paying authors advances and royalties, publishers provide editorial, design, marketing, publicity and other services to authors. Publishers also arrange for printing and distribution of books to wholesalers and retailers.

24. Authors are compensated in the form of an advance and royalties. An advance is essentially an up-front payment of royalties expected to accrue from future sales of the book.

The royalty rate is a fixed percentage of sales that is set by the publisher and is rarely negotiated. If a book "earns out" by earning royalties that exceed the amount of the advance, the author receives additional payments from further sales at the agreed upon royalty rate. Most authors do not earn out their advance and thus their advance generally constitutes their entire earnings from their book. Consequently, the key financial determinant in most negotiations is the size of the advance and its payout structure (*e.g.,* the number of installments the advance is divided into, and the timing of each such payment).

25. Authors' agents seek to maximize the amount paid to authors for licensing the rights to publish their clients' books. In order to secure the most favorable terms for their clients, agents typically submit a book proposal, which can be a complete manuscript, an outline for a book, or just an idea for a book, to several publishers seeking offers. If there are enough interested publishers, agents can set up a competitive bidding situation such as an auction where multiple publishers bid to acquire the rights to the book.

26. In the United States, books are sold through several retail sales channels, including online retailers such as Amazon, national bookstore chains such as Barnes & Noble and Books-A-Million, independent bookstores such as The Strand and Politics & Prose, big-box stores such as Target, Walmart and Costco, and specialty retailers such as Anthropologie and Bass Pro Shops. In the United States, books also are sold to retailers and institutional buyers (including schools and libraries) through wholesalers such as Ingram and Readerlink. Publishers set the cover or "list price" of a book and sell the books to retailers at a standard discount from the list price (a little less than half-off for most types of print books). Publishers also may offer retailers marketing and other promotional discounts in addition to the standard discount off of list.

B. Penguin Random House and Simon & Schuster are Two of the Big Five Book Publishers in the United States

27. The book publishing market in the United States is dominated by the Big Five publishers. In the words of Simon & Schuster's former CEO, the Big Five are one another's "biggest competitors." In addition to strong editorial and publishing capabilities, the Big Five generally offer larger marketing and promotional budgets, and employ dedicated teams of sales representatives who service retailers and promote an author's books.

28. In order to solicit the most attractive bids for their clients, authors' agents typically submit manuscripts to some or all of the Big Five publishers—especially Penguin Random House, which has, by far, the largest number of imprints and publishes the most new books in the United States. Authors generally choose to work with a publisher they believe will bring them the best chance of success, usually based on a combination of advance and other financial terms and, as Simon & Schuster's former CEO put it, "editorial match, a feel the editor and [publishing] house understands what they are writing, and publishing vision as to how to bring the book to market and create an audience for it."

C. Smaller Publishers are Limited in their Ability to Compete Effectively with the Big Five

29. Smaller publishers lack the resources and capabilities of the Big Five publishers, and thus they are limited in their ability to compete for the publishing rights to anticipated top-selling books. Smaller publishers typically have smaller "backlists" (*i.e.*, inventories of older titles that continue to generate sales) than the Big Five, which are a critical source of revenue that allow the Big Five to pay more and higher advances to authors. Smaller publishers also lack scale in book sales. With fewer titles to rely on for sales, smaller publishers lack the financial resources to (1) regularly pay the advances required to secure

publishing rights to anticipated top-selling books, and (2) absorb the financial losses from books that do not meet their sales expectations. While smaller publishers occasionally win auctions for anticipated top-selling books, it is the exception rather than the norm. Smaller publishers typically have lower marketing and promotional budgets, fewer experienced sales representatives, and less robust in-house distribution capabilities compared to the Big Five. Authors of anticipated top-selling books generally seek publishers who have the prestige, reputation, experience, and ability to maximize the book's chances of becoming commercially successful. Therefore, authors of anticipated top-selling books generally do not view smaller publishers as competitively significant options compared to the Big Five.

30. The Defendants recognize that smaller publishers are limited in their ability to compete with the Big Five for the rights to publish anticipated top-selling books. In the words of the late CEO of Simon & Schuster, the "myriad smaller publishers" in the United States "rarely compete with us in auctions for new properties. Often these publishers become farm teams for authors who then want to move to a larger, more financially stable major publisher."

RELEVANT MARKETS

31. A typical starting point for merger analysis is defining a relevant market, which has both a product and a geographic dimension. Courts define relevant product markets to help determine the areas of competition most likely to be affected by the merger.

32. The proposed acquisition would result in the lessening of competition in each of the two product markets described below. Each of these products constitutes a line of commerce as that term is used in Section 7 of the Clayton Act, 15 U.S.C. §18, and each is a relevant product market in which competitive effects can be assessed. As recognized by the

Supreme Court and the U.S. Department of Justice and Federal Trade Commission *Horizontal Merger Guidelines*, the focus in defining product markets is the extent of substitution in response to changes in price. One tool used to assess substitution in markets composed of buyers of goods is known as the "hypothetical monopsonist" test. This test, as described in the *Horizontal Merger Guidelines*, asks whether a firm that was the only buyer of a product (a hypothetical monopsonist) would profitably impose a price reduction—specifically, a small but significant and non-transitory reduction in price (a "SSNRP")—on at least one product purchased by the merging firms in the relevant market. As described below, each relevant product market satisfies this hypothetical monopsonist test.

A. Product Markets

1. *The Acquisition of U.S. Publishing Rights to Books from Authors is a Relevant Product Market*

33. The acquisition of U.S. publishing rights to books from authors (hereinafter referred to as "content acquisition") is a relevant market and line of commerce within the meaning of Section 7 of the Clayton Act. In this market, authors sell the rights to publish their works in the United States, and publishers agree to provide editorial, design, printing, sales and distribution, marketing, publicity, or other services to authors. The market is differentiated, meaning that publishers have differing capabilities and resources they can offer to authors. In addition, advances are individually negotiated, which allows each publisher to bid higher or lower depending on its perception of the competition it faces in seeking to acquire the rights for any given book. A hypothetical monopsonist of the U.S. publishing rights to books would profitably decrease the advances paid to authors by a small but significant, non-transitory amount.

34. Self-publishing is not a reasonable alternative for most authors seeking to sell the publishing rights to their books in exchange for an advance. By definition, self-publishing does not pay authors advances, which authors often use to fund their writing. Self-publishing also does not include the breadth of editorial, distribution, and marketing services that are important factors in whether a book will become commercially successful. Indeed, an internal Simon & Schuster document acknowledged that "[s]elf-publishing is not viewed as a threat to [our] core business." Authors of books would not substitute to self-publishing in sufficient numbers to deter a hypothetical monopsonist from imposing a small, but significant, and non-transitory decrease in advances.

35. Some publishers hire authors on a "work-for-hire" basis to draft books conceived of by the publisher, not the author. The publisher, and not the author, owns the publishing rights in a work-for-hire arrangement. Moreover, such authors generally are compensated differently than authors who sell the rights to publish their books in exchange for an advance and royalties. Authors of books would not substitute to work-for-hire arrangements in sufficient numbers to deter a hypothetical monopsonist from imposing a small, but significant, and non-transitory decrease in advances.

2. *The Acquisition of U.S. Publishing Rights to Anticipated Top-Selling Books is also a Relevant Product Market*

36. The acquisition of the U.S. publishing rights to anticipated top-selling books is a relevant product market and line of commerce under Section 7 of the Clayton Act. The market for the acquisition of U.S. publishing rights to anticipated top-selling books is narrower than, and included within, the market for the acquisition of U.S. publishing rights to books.

37. The authors of anticipated top-selling books generally command higher advances than other authors. Penguin Random House and Simon & Schuster typically require senior executives to review and approve such purchases based on projected profit-and-loss statements ("P&Ls") prepared by editors. These P&Ls include the sales expected to be derived from the book based upon the sales history of comparable books or other works by the same author, production and marketing costs, and the book's expected list price. The higher the anticipated sales, the higher a publisher is generally willing to bid on the advance.

38. It is appropriate to define relevant product markets around purchases made from certain types of sellers, such as authors of anticipated top-selling books. The publishing industry displays the characteristics identified in § 3 of the *Horizontal Merger Guidelines* for when markets may be defined in this way: prices (*i.e.,* advances) are individually negotiated and publishers have information that allows them to identify authors that have fewer competitive options. Publishers know based on experience that if the bidding for a particular book exceeds a certain advance level, they are likely bidding against a limited set of competitors that have the financial wherewithal to pay for the advance, the publishing expertise to attract and serve authors of anticipated top-selling books, and the capability to generate sufficient sales to justify the advance. Publishers take this into account when deciding how much to bid on advances for a particular book. Given the individualized nature of the negotiations, publishers can target authors of anticipated top-selling books by offering lower advances and authors cannot arbitrage to avoid lower advances. As a result, a hypothetical monopsonist of anticipated top-selling books would profitably reduce advances paid to authors of anticipated top-selling by a small but significant, non-transitory amount.

39. Self-publishing and work-for hire arrangements are not reasonable alternatives for authors seeking to sell the rights to publish their books in exchange for an advance. As noted above, self-published and work-for-hire authors typically do not receive advances for their work. Moreover, authors who publish their own books retain the publishing rights, while work-for-hire authors do not possess publishing rights to begin with. In other words, neither self-publishing nor work-for-hire arrangements involve the *acquisition* of publishing rights from authors. Not enough authors of anticipated top-selling books would switch to self-publishing or work-for-hire arrangements to deter a hypothetical monopolist from imposing a small but significant, non-transitory decrease in advances.

B. Geographic Markets

40. Penguin Random House and Simon & Schuster compete to acquire the rights to publish books in the United States. Authors who sell U.S. publishing rights are predominantly located in the United States but can reside anywhere in the world. The market includes publishers who acquire U.S. publishing rights even when those publishers are located outside the U.S. Accordingly, the relevant geographic markets for content acquisition are global.

ANTICOMPETITIVE EFFECTS

41. The proposed merger would eliminate a major competitor to Penguin Random House, already the market leader, and create a firm that controls a substantial share of the relevant markets. The merger would also result in significantly increased concentration in the relevant markets, which have experienced significant consolidation in recent years. Post-

merger, the market for the acquisition of U.S. publishing rights to anticipated top-selling books would be highly concentrated.[2] The merger is presumptively unlawful.

A. The Proposed Merger Would Eliminate Head-to-Head Competition Between Penguin Random House and Simon & Schuster, Depressing Author Pay and Reducing the Quantity and Variety of Titles Published

42. If Defendants' proposed merger is allowed to proceed, Penguin Random House would account for close to half of the market for the acquisition of U.S. publishing rights to anticipated top-selling books. Penguin Random House's next largest competitor would be less than half its size. Post-merger, the merged firm and its next largest competitor would account for more than two-thirds of that market.

43. Penguin Random House and Simon & Schuster compete closely to acquire the rights to anticipated top-selling books. They almost always are invited to bid in auctions for anticipated top-selling books, are often the top two bidders, and frequently lose to each other. For example, in September 2019, after learning that Simon & Schuster lost an auction to Penguin Random House, Simon & Schuster's then-President and current CEO wrote to his boss: "This was the third [book] we lost this week to PRH [and] . . . [t]here may have been a fourth."

44. The head-to-head competition between Defendants has allowed authors of anticipated top-selling books to secure higher advances and other favorable terms. For

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[2] To measure market concentration, courts often use the Herfindahl-Hirschman Index ("HHI") as described in § 5.3 of the *Horizontal Merger Guidelines*. HHIs range from 0 in markets with no concentration to 10,000 in markets where one firm has 100 percent market share. Under the *Horizontal Merger Guidelines*, when a merger increases the HHI in any market by more than 200 and results in an HHI above 2,500, the market is "highly concentrated" and the transaction is presumed to be anticompetitive. Here, the proposed merger would create a highly concentrated market for the acquisition of U.S. publishing rights to anticipated top-selling books and is presumptively anticompetitive.

example, in January 2019, Simon & Schuster tried to acquire the memoir of a Grammy-Award winning singer and avoid competing in an auction by making a pre-emptive offer for $5 million. After this initial offer was rejected, Simon & Schuster increased its bid to $6 million, and Penguin Random House countered with $7 million plus $2.5 million in potential bonuses. Upon hearing of Penguin Random House's bid, Simon & Schuster's then-President emailed his boss: "I'm concerned that if we offer less than $8 million, [the author's agent] will go back to PRH. She said they were willing to offer more." Simon & Schuster eventually won with a bid of $8 million.

45. In mid-2019, Penguin Random House, Simon & Schuster, and Hachette were invited to bid on a book proposal based on a Broadway play. Penguin Random House and Simon & Schuster submitted equivalent bids; Hachette's was lower. The author's agent then asked for "best bids" from Penguin Random House and Simon & Schuster, both of which knew they were competing against the other. Simon & Schuster submitted a bid of $1.4 million, whereas Penguin Random House's bid was closer to $1.25 million. Upon learning this, Penguin Random House's U.S. CEO agreed to match Simon & Schuster at $1.4 million. At that point the auction was a dead-heat, with each publisher trying to win the "beauty contest" between them by pointing to the superior services each could provide to the author, including marketing, publicity, and editorial support. As Simon & Schuster's current CEO summed it up: "The choice is between Simon & Schuster and RH and we'll find out today." The author eventually chose Penguin Random House.

46. That same month, an agent sent a proposal to four of the Big Five publishers for a book on the Mueller investigation. Only Simon & Schuster and Penguin Random House submitted offers. After hearing that its bid of $625,000 was lower, Simon & Schuster

increased its bid to $1.5 million. A senior Simon & Schuster executive told the agent that Simon & Schuster had not offered her agency "an advance of this magnitude to a new author in the nine years I've been here." Penguin Random House increased its offer to $1.5 million plus up to $500,000 in sales bonuses. After hearing that the author chose Penguin Random House, the Simon & Schuster executive wrote the CEO: "I did everything I could and we lost to Random House … Frustrating."

47. In 2020 Penguin Random House and Simon & Schuster competed in an auction for a book on gender inequality. After the first round, three bidders remained, including Penguin Random House and Simon & Schuster, with Simon & Schuster submitting the highest bid at $475,000. After the third bidder dropped out, Simon & Schuster and Penguin Random House drove the bidding up to $625,000 and $650,000 respectively. Subsequently, the agent asked for best and final bids, and Simon & Schuster bid $750,000. Suspecting that it was bidding against Simon & Schuster, Penguin Random House stretched its bid to $775,000. After winning the contract, the acquiring editor emailed her colleague: "we prevailed over . . . S&S." Her colleague replied: "[W]e got this one, and over stiff competition."

48. Penguin Random House and Simon & Schuster again went down to the wire in another fierce contest for an author's debut novel. After multiple rounds of bidding, the author's agent announced that only the two top bidders would be allowed to continue. Penguin Random House and Simon & Schuster were the two highest at $510,000 and $525,000, respectively. They continued bidding against one another for several additional rounds. Upon hearing that the other bidder had put in a final offer just shy of $700,000, Simon & Schuster increased its offer from $525,000 to $700,000 and won the auction.

49. Penguin Random House and Simon & Schuster also competed for a book on the opioid epidemic in an auction in early 2020. When the bidding reached $645,000 after several rounds, the other bidders dropped out leaving Penguin Random House and Simon & Schuster as the only remaining bidders. Penguin Random House and Simon & Schuster then went back and forth with competing bids for multiple rounds, with Penguin Random House eventually prevailing with a winning bid of $825,000.

50. In the broader product market for content acquisition, the merger would harm a wide spectrum of authors who benefit from competition between Penguin Random House and Simon & Schuster today. While smaller publishers can be competitive alternatives for some authors whose works are not anticipated to be top sellers, the merger is likely to harm any author who views Penguin Random House and Simon & Schuster as close substitutes and would benefit from head-to-head bidding by these competitors. For example, Penguin Random House and Simon & Schuster were the final two bidders for a book by a freelance science journalist, and their direct competition drove the final advance up substantially above Penguin Random House's initial offer. Penguin Random House's successful final bid was $15,000 higher than Simon & Schuster's best bid, a difference the author indicated would help pay for her son's college tuition. The fact that smaller publishers may be an acceptable alternative for certain authors will not protect other authors who have benefitted from competition between Penguin Random House and Simon & Schuster, and would continue to benefit in the future if the merger is enjoined.

51. By eliminating the head-to-head competition between Penguin Random House and Simon & Schuster, the proposed merger would likely result in authors earning less for their books. Because many authors do not earn out their advances, the advance often

represents the sum total of an author's compensation. A reduction in author compensation is likely to lead to fewer authors being able to make a living from writing and fewer and less diverse books being published.

B. Penguin Random House's Proposed Acquisition of Simon & Schuster Would Facilitate Coordination Among the Remaining Big Five Publishers

52. In addition to eliminating head-to-head competition, the proposed merger is also likely to reduce competition by facilitating coordination between the remaining major publishers. The market structure of the publishing industry already is conducive to coordinated behavior. A few large players dominate the industry and the terms of author contracts, other than advances, have become fairly standardized over time. For example, royalty rates are typically identical among the Big Five publishers and are rarely negotiable. Similarly, audio rights used to be negotiated separately but the Big Five publishers now generally demand that authors bundle audio rights with print and electronic rights. If this merger is allowed to proceed, the Big Five would be reduced to the Big Four, with the merged firm nearly twice as large as its next largest competitor. Penguin Random House would thereby cement its position as the key leader for other publishers to follow. With fewer players and an obvious leader, the Big Four would likely find it easier to reach and sustain a consensus that harms authors through coordination. For example, the new Big Four could tacitly agree to extract a broader scope of rights by requiring authors to sell worldwide publishing rights (instead of U.S. or North American-only publishing rights), or they could pay out advances in smaller increments or over longer periods of time. Information about rival publishers' actions is widely available in this industry, and communications between employees of rival publishers is common, making deviations from any industry understanding or agreement more easily detectable.

53. The risks of post-merger coordination are substantial. The Big Five have a history of collusion. In 2012 the United States filed a complaint in the District Court for the Southern District of New York alleging that five publishers—including Penguin and Simon & Schuster—conspired with Apple to increase the prices of e-books. After a trial, the District Judge found that Apple and the publishers had indeed engaged in a price-fixing conspiracy in violation of Section 1 of the Sherman Act, a judgment that was affirmed by the Second Circuit.

LACK OF COUNTERVAILING FACTORS

A. Entry Barriers are High and Will Increase With this Merger

54. There are high barriers to economically meaningful entry or repositioning in the markets for content acquisition, and thus new entry or repositioning by existing competitors is unlikely to prevent or counteract the proposed acquisition's likely anticompetitive effects. It can take many years and significant financial investment for a publisher to accumulate a stable of backlist titles, which are a crucial source of revenue used to fund author advances for new books. In addition to sufficient financial resources, infrastructure and scale, a publisher needs name recognition and a demonstrated track record to convince authors of anticipated top-selling books to consider switching publishers. Because authors must entrust their work to a publisher for the entire lifecycle of a book (often spanning years), it is important to authors of anticipated top-selling books that a publisher has a proven track record of producing commercially successful books. One internal Bertelsmann analysis of the potential merger succinctly described the barriers to entry as "high (mainly reputation, distribution)."

55. In addition, many smaller publishers lack distribution capabilities and depend upon Penguin Random House and Simon & Schuster for distribution services. These services include: selling books to retailers and other customers; warehousing; order fulfillment and shipping (often referred to as "pick, pack, and ship"); invoicing and collections; and returns processing. The merged firm would have even greater control over distribution services, giving it more power over competitors and allowing Defendants to raise competitors' costs or enhance barriers to entry or re-positioning.

B. There Are No Merger-Specific Efficiencies that Outweigh the Likely Harm to Competition from this Merger

56. Defendants have claimed that the proposed acquisition would generate synergies by combining the operations of Penguin Random House and Simon & Schuster. But Penguin Random House's own executives have raised doubts about these synergy claims. For example, Penguin Random House's COO, who is charged with integrating Simon & Schuster into Penguin Random House, has characterized the "synergies task" as "extremely aggressive." Similarly, Penguin Random House's Global CEO testified that he is "not convinced" that Penguin Random House's U.S. management will take the steps necessary to achieve the planned synergies. To the extent the proposed transaction would result in any verifiable, transaction-specific efficiencies in the alleged relevant markets, such efficiencies are unlikely to outweigh the transaction's likely anticompetitive effects.

C. This Merger Will Not Provide a Counterweight to Amazon's Alleged Buying Power

57. Although Penguin Random House has publicly stated that the merger with Simon & Schuster will provide a counterweight to Amazon's alleged buying power, its internal documents tell a different story: Penguin Random House plans to embrace Amazon even

more closely after the merger. For example, in seeking approval from Bertelsmann's Supervisory Board to pursue Simon & Schuster, Penguin Random House executives stated that the acquisition would advance their "[g]oal" to be an "[e]xceptional partner for Amazon." Penguin Random House's Global CEO has also refuted this claim. When asked whether he viewed the proposed merger as a counterweight to Amazon, he replied: "No, I've never, never bought into that argument… I am convinced it is not the case in the coming together of Penguin Random House and Simon & Schuster."

D. Penguin Random House's Proposed "Fix" Would Not Preserve Competition Between Defendants

58. Aware of the competitive concerns raised by agents and authors, as well as the ongoing antitrust scrutiny of this merger by the United States, Defendants have tried to salvage their deal by making an unenforceable promise to continue competing after the merger is consummated. On September 20, 2021 Penguin Random House announced that, after the merger, it would allow Penguin Random House imprints and legacy Simon & Schuster imprints to continue bidding against one another up to an unspecified amount. In short, after securing nearly half the market for publishing rights to anticipated top-selling books, Penguin Random House asks this Court to trust that Penguin Random House will not use its market power to maximize profits for the benefit of its shareholders but rather, it will essentially compete with itself to reduce those profits. This proposal defies economic sense, can be evaded or violated without detection, and is unenforceable.

VIOLATIONS ALLEGED

59. If allowed to proceed, Penguin Random House's proposed acquisition of Simon & Schuster would eliminate competition between Penguin Random House and Simon &

Schuster and would likely lessen competition substantially in the markets for content acquisition in the United States in violation of Section 7 of the Clayton Act, 15 U.S.C. § 18.

60. Among other things, the transaction would:

a. eliminate competition between Penguin Random House and Simon & Schuster;

b. facilitate coordination between the combined firm and the remaining Big Five publishers;

c. likely cause author income to be less than it would be otherwise;

d. likely cause a reduction in the quantity and variety of books published by the merged firm; and

e. likely reduce quality, service, choice, and innovation.

REQUEST FOR RELIEF

61. The United States requests:

a. that Penguin Random House's proposed acquisition of Simon & Schuster be adjudged to violate Section 7 of the Clayton Act, 15 U.S.C. § 18;

b. that the Defendants be permanently enjoined and restrained from carrying out the proposed acquisition of Penguin Random House by Simon & Schuster or any other transaction that would combine the two companies;

c. that the United States be awarded costs of this action; and

d. that the United States be awarded such other relief as the Court may deem just and proper.

Dated: November 2, 2021

Respectfully Submitted,

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*LEAD ATTORNEY TO BE NOTICED

Simon & Schuster Inc. is a subsidiary of ViacomCBS Inc. and is headquartered in New York, New York. Simon & Schuster publishes 1,000 new trade books in the United States annually. In 2019, Simon & Schuster reported revenues of $760 million from U.S. publishing.

Attachment(s):
Download Complaint - PRH and S&S.pdf

Topic(s):
Antitrust

Component(s):
Antitrust Division
Office of the Attorney General

Press Release Number:
21-1081

Updated November 2, 2021

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

UNITED STATES OF AMERICA *Plaintiff*, v. BERTELSMANN SE & CO. KGaA, PENGUIN RANDOM HOUSE, LLC, VIACOMCBS, INC., and SIMON & SCHUSTER, INC. *Defendants*.	Civil Action No. 1:21-cv-02886-FYP

AMENDED ANSWER

Defendants Bertelsmann SE & Co. KGaA, Penguin Random House LLC, ViacomCBS Inc., and Simon & Schuster, Inc. respond to the allegations of the Complaint as set forth below. Any allegation not specifically and expressly admitted is denied.

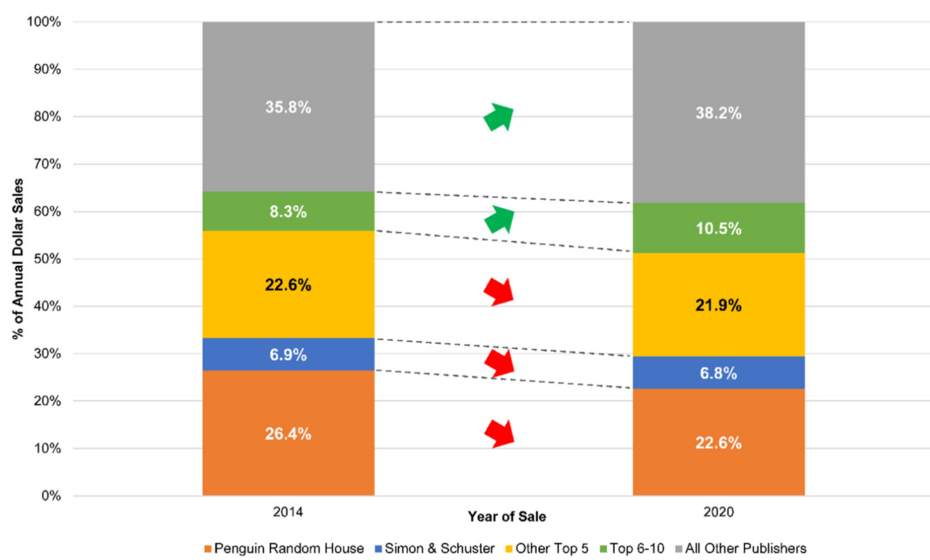
GENERAL RESPONSE TO PLAINTIFF'S ALLEGATIONS

1. The mission of Penguin Random House and Simon & Schuster is to create the future of reading for generations to come. Authors are central to their mission. As book publishers, they focus on discovering and nurturing authors, supporting authors' creative efforts, and investing in authors' careers by promoting and selling their works. All of these efforts ultimately increase author compensation.

2. When storied publishing house Simon & Schuster was put up for sale, Penguin Random House saw an opportunity to build on the legacy of Simon & Schuster's imprints by nurturing their existing author relationships and identifying new authors to cultivate. The transaction will benefit not just the many thousands of Simon & Schuster authors but also book retailers and consumers. Penguin Random House plans to reinvest its savings from the merger to

grow title acquisitions and continue its support of brick-and-mortar booksellers. By giving Simon & Schuster authors access to Penguin Random House's highly efficient supply chain, their books will be more discoverable, visible, and available—online, internationally, and down the street. Penguin Random House's extensive supply capabilities are increasingly important to neighborhood book stores as they strive to compete with Amazon's almost infinite book selection and highly efficient delivery capabilities. Expanding Penguin Random House's supply chain to include Simon & Schuster authors ultimately provides greater income for authors and more choices for readers.

3. The merger's pro-competitive effects are not just aspirational, but are borne out by precedent. After the 2013 merger between Random House and Penguin, competition in the markets for books and book rights intensified. The trade-book market in the U.S. has expanded substantially, with more titles being published every year. And publishers outside the so-called "Big Five" have been *gaining* share in the retail market for book sales at the expense of the "Big Five," driving the "Big Five's" share down to only about 50% of the overall book market:



Source: [1] BookScan

4. Notably, the Department of Justice ("DOJ") does not allege that the merger will reduce competition in the market for book sales or raise prices for consumers. DOJ professes a different concern: it wants to protect the most successful authors, those with sophisticated agents and the most lucrative book contracts. To secure that protection, DOJ invents a market for rights to "anticipated top-selling books" that excludes the vast majority of authors and lacks any basis in either the real world or accepted market-definition analysis. According to DOJ, only the "Big Five" publishers today regularly compete to acquire rights in this invented market. Reducing that number to four, DOJ asserts, will diminish competitive high-end bidding and thus reduce the royalty advances that authors obtain for their works.

5. DOJ's theory is factually wrong and legally baseless. On the facts, DOJ errs in asserting that the "Big Five" are the only participants in the alleged market of "anticipated top-selling books." As just one example, in each of the past three years, three of the top ten highest-selling authors according to BookScan have been published by publishers other than the so-called "Big Five."

6. On the law, DOJ's theory is flawed, starting with the fictional market on which it depends: a supposed market for "anticipated top-selling books." DOJ defines this market according to the amount of advance royalties the author receives, but does not identify the market-defining amount. And the publishing industry does not divide the market for book rights into distinct categories based on the author's compensation for the book or whether it is anticipated to be a top seller. The royalty advance for a proposed book is driven mainly by the reader demand a particular editor anticipates for that particular book. Because books are not commoditized consumer products, editors at different publishers have different expectations for any given book. There is no identifiable advance level above which only certain publishers

compete for book rights. DOJ's failure to identify any such market-defining "price" is critical: like any antitrust plaintiff, DOJ cannot claim harm to a market without identifying the essential facts that define the alleged market. What is more, the concept of a distinct market for "premium" goods defined solely by price has been rejected by multiple courts.

7. The only potentially legitimate market in this context is the market for rights in all proposed books. And as to that market, DOJ barely makes any allegations at all. Most important, DOJ alleges no cognizable competitive harm—it does not even suggest that the merger will cause a market-wide decline in royalty advances or in overall author compensation. To the contrary, DOJ affirmatively concedes that in the market for all book rights, hundreds of small and mid-size publishers provide a competitive alternative to the largest publishing houses, foreclosing any possibility that the merger could diminish competition in the only plausibly relevant market.

8. Even in its made-for-litigation market artificially limited to only the richest royalty advances, DOJ cannot show that the merger will cause authors to accept lower advances than they did before the merger. DOJ does not deny that competition will remain robust in the market to sell books to readers. And publishers can sell books only if they first obtain the rights to publish them. To compete successfully in the book market, then, a post-merger Penguin Random House that would include Simon & Schuster, along with all its rivals, will have every incentive to continue competing aggressively in the book-*rights* market, *especially* for the rights to books they expect to be most successful. These are the most sought-after books, where authors and their sophisticated agents have the greatest negotiating leverage. The merger will neither reduce that leverage nor lessen the incentives of Penguin Random House and its competitors to make aggressive offers for the most coveted books.

9. A post-merger Penguin Random House will have no power to compel authors to accept lower advance royalties for the most sought-after books. The combined company will still be competing for the rights to those books against not only the other remaining largest publishers, but also the many small and mid-size publishers that often compete in—and often *win*—bidding for the most valuable properties. These rivals either are already active participants in high-end bidding today, or could easily become vigorous competitors after the merger.

10. DOJ tries to discount the competitive effect of smaller publishers by asserting that any one of them does not compete in high-end bidding today as often as the "Big Five" houses do. DOJ misses the point: what matters is that in bidding for any *given* book, *at least one* smaller publisher often competes. And in fact, the available data show that these publishers win bidding for books more often than Simon & Schuster does. DOJ also ignores how easily many publishers outside the "Big Five"—which include such media heavyweights as Disney, Amazon, and Scholastic, as well as brand-name publishing "imprints" like Norton and Abrams and new entrants like Zando—could increase their participation in high-end bidding. In short, after the merger, authors will still have a vast array of buyers for their book proposals, particularly for books expected to be "top sellers."

11. DOJ's theory also erroneously assumes that price effects in the post-merger marketplace can be predicted based on a simple analysis of market shares. That assumption is wrong not only because DOJ misdefines the market, mischaracterizes its participants, and miscalculates market shares, but also because DOJ misunderstands the most basic dynamics of the book-rights market. Like books themselves, transactions in book rights are personal and individualized, especially in high-dollar deals. These transactions are controlled by the author's agent, who is almost always a sophisticated repeat player. The agent decides which publishers

can bid, how the bidding process will work, and what rights will be offered. Agents invite bids from select imprints based on myriad factors—often highly subjective—that depend on the specific proposed book. Penguin Random House has no ability to influence overall advances or compensation: a Penguin Random House imprint is not invited to bid for every book, and even when one or more Penguin Random House imprints do bid, they lose far more auctions than they win. The same is true for Simon & Schuster. After the merger, the market dynamic will be just the same, and post-merger Penguin Random House's pricing influence will be just as nonexistent as it is today.

12. For these and other reasons, DOJ cannot show that the merger will likely reduce competition or diminish pay for book rights at any level of the market. The merger will instead allow Penguin Random House to bring enhanced distribution capacity to a greater number of authors, including Simon & Schuster's authors. The proposed merger is procompetitive in every way. DOJ's challenge should be rejected.

RESPONSE TO SPECIFIC ALLEGATIONS

1. Defendants admit that authors and books are vitally important to our culture and society.

2. Defendants lack knowledge or information sufficient to admit or deny the allegations of paragraph 2, except Defendants deny that Penguin Random House's proposed acquisition of Simon & Schuster would result in substantial harm to authors and that Penguin Random House's proposed acquisition of Simon & Schuster would result in particular harm to authors of "anticipated top-selling books," which is not an ascertainable category, and admit that Penguin Random House and Simon & Schuster, as well as dozens of other publishers, have competed to acquire publishing rights.

3. Defendants lack knowledge or information sufficient to admit or deny the allegations in the first two sentences of paragraph 3 because the Complaint does not state what metric is being used as basis for the allegations. Defendants further respond that Plaintiff's selective quotation in the third sentence is taken out of context and refer the Court to the document itself.

4. Defendants lack knowledge or information sufficient to admit or deny the allegations of paragraph 4, except Defendants admit that, by some measures, Penguin Random House, Simon & Schuster, HarperCollins Publishers, Hachette Book Group, and Macmillan Publishers constitute what some in the publishing industry refer to as the "Big Five" U.S. publishers and deny the allegations in the second sentence. Defendants further respond that Plaintiff's selective quotation in the third sentence is taken out of context and refer the Court to the document itself.

5. Defendants lack knowledge or information sufficient to admit or deny the allegations of paragraph 5, except Defendants admit that publishing can be a risky business; many books published do not earn a profit for the publisher; publishers often pay significant advance royalties to authors when they present an attractive book concept; some authors do not earn additional royalties; Penguin Random House and Simon & Schuster have provided editorial, production, marketing, and publicity support to authors; and Penguin Random House and Simon & Schuster have sales and distribution networks.

6. Defendants deny the allegations of paragraph 6. Defendants further respond that Plaintiff's selective quotations in the second and third sentences are taken out of context and refer the Court to the documents themselves.

7. Defendants deny the allegations of the first three sentences of paragraph 7. Defendants lack knowledge sufficient to admit or deny the allegations of the fourth sentence of paragraph 7, but state that the chart is at best misleading, if not simply wrong, and shows that competitors to Penguin Random House and Simon & Schuster have themselves paid hundreds of millions of dollars in author advances, often by bidding more than Penguin Random House and Simon & Schuster.

8. Defendants lack knowledge or information sufficient to admit or deny the allegations of paragraph 8, except Defendants admit that Penguin Random House competes with dozens of publishers to acquire content and Simon & Schuster is one of them; that Penguin Random House and other publishers, including Simon & Schuster, are invited by agents to bid on potential book concepts; and that competition among all publishers, including Penguin Random House and Simon & Schuster, yields more favorable contract terms for potential authors.

9. Defendants deny the allegations of paragraph 9. Defendants further respond that Plaintiff's selective quotations in the paragraph are taken out of context and refer the Court to the documents themselves.

10. Defendants deny the allegations of paragraph 10, except Defendants admit that some employees have publicly suggested that the merger is necessary to compete with Amazon because Amazon is the largest company facilitating self-publishing, is increasingly aggressive in contract negotiations, and has leverage over the industry due to its strength as a bookseller. Defendants further respond that Plaintiff's selective quotations in the paragraph are taken out of context and refer the Court to the documents themselves.

11. Defendants deny the allegations of paragraph 11. Defendants further respond that Plaintiff's selective quotations in the paragraph are taken out of context and refer the Court to the documents themselves.

12. Defendants deny the allegations of paragraph 12.

13. Defendants deny that the proposed transaction would lessen competition in any relevant market or otherwise violate the Clayton Act and that Plaintiff is entitled to any relief. Defendants admit that Plaintiff has filed its complaint under Section 15 of the Clayton Act and seeks an injunction under Section 7 of the Clayton Act.

14. Defendants deny the allegations of paragraph 14, except Defendants admit that Penguin Random House and Simon & Schuster are engaged in interstate commerce and that they acquire some publishing rights from authors.

15. Defendants deny the allegations of paragraph 15, except Defendants admit that this Court has personal jurisdiction over Defendants because they have consented to personal jurisdiction in this Court for this litigation and that Penguin Random House and Simon & Schuster transact business within the District of Columbia.

16. Defendants admit the allegations of paragraph 16.

17. Defendants admit the allegations of paragraph 17.

18. Penguin Random House admits the allegations of paragraph 18. ViacomCBS and Simon & Schuster lack knowledge or information sufficient to admit or deny the allegations of paragraph 18.

19. Defendants admit the allegations of paragraph 19.

20. Defendants admit the allegations of paragraph 20, except that Defendants lack knowledge or information sufficient to admit or deny the allegation that Simon & Schuster is the

fourth largest U.S. trade book publisher because the Complaint does not state what metric is being used as the basis for that allegation.

21. Defendants admit the allegations of paragraph 21.

22. Defendants deny the allegations of paragraph 22, except Defendants admit that the term "general trade books" is widely used in the publishing industry and generally refers to books that are published for wide public consumption, including both fiction and some non-fiction, but does not include academic texts or professional manuals, and that bringing a book to market in the United States requires the cooperation of authors and others.

23. Defendants deny the allegations of paragraph 23, except Defendants admit that book publishing is a collaborative effort between authors and publishers; authors write draft manuscripts or proposals for books and rely on agents to represent them in obtaining the best publisher for the potential book and negotiate on their behalf; when publishers obtain the right to publish a book, agents determine whether that right includes different formats and limited geographic scope; publishers compete for publishing rights on several different dimensions, including the amount of the advance payments, the editor's vision for the book, and the connection the author feels to the editor; publishers typically pay authors royalties and advances on expected royalties and edit the book, market it, and arrange for printing and distribution.

24. Defendants deny the allegations of paragraph 24, except Defendants admit that authors can be compensated in the form of royalties, a portion of which are often paid in advance; if the author's compensation is based on royalties and the author's book "earns out" by earning royalties in excess of the advance, the author receives additional payments from further sales at the agreed-upon royalty rate; and some authors do not earn out their advance on a particular book.

25. Defendants deny the allegations of paragraph 25, except Defendants admit that authors' agents generally seek to maximize the amount paid to their clients; agents typically submit book proposals to several publishers; agents generally seek bids for these book proposals; and multiple publishers often compete to win rights to the potential book.

26. Defendants deny the allegations in the third sentence of paragraph 26, except admit that publishers often set the cover or "list price" of physical books and sell physical books to retailers, wholesalers, and distributors at a discount from that price. Defendants admit the other allegations of paragraph 26.

27. Defendants deny the allegations of paragraph 27. Defendants further respond that Plaintiff's selective quotation in the paragraph is taken out of context and refer the Court to the document itself.

28. Defendants lack knowledge or information sufficient to admit or deny the allegations in paragraph 28, except Defendants admit that authors' agents attempt to solicit the most attractive bids for their clients; authors generally choose to work with a publisher they believe will bring them the best chance of success; and Penguin Random House has the largest number of imprints and publishes the most new books in the United States each year. Defendants further respond that Plaintiff's selective quotation in the paragraph is taken out of context and refer the Court to the document itself.

29. Defendants deny that publishers outside of the "Big Five" lack the ability to compete for publishing rights, including for rights to books that are expected to sell a lot of copies, and the other allegations of paragraph 29.

30. Defendants deny the allegations of paragraph 30. Defendants further respond that Plaintiff's selective quotation in the paragraph is taken out of context and refer the Court to the document itself.

31. Defendants deny that Plaintiff has identified a relevant market and that competition will be harmed in the appropriate relevant market. Defendants admit that defining a relevant market correctly is necessary to assess whether there is harm to competition from a merger.

32. Defendants deny the allegations of paragraph 32.

33. Defendants deny the allegations of paragraph 33, except Defendants admit that there is a differentiated market; advances are individually negotiated; and each individual publisher makes its own decision about what to bid in seeking to acquire the rights for any given book and often considers the expected level of overall interest in the title among publishers.

34. Defendants deny the allegations of paragraph 34. Defendants further respond that Plaintiff's selective quotation in the paragraph is taken out of context and refer the Court to the document itself.

35. Defendants lack knowledge or information sufficient to admit or deny the allegations of paragraph 35, except Defendants admit that some publishers hire authors to draft books originally conceived by the publisher and that such authors are sometimes compensated differently than other authors.

36. Defendants deny the allegations of paragraph 36.

37. Defendants deny the allegations of paragraph 37, except Defendants admit that senior executives of Penguin Random House and Simon & Schuster review some proposed advances and that such review might include review of a P&L projection, and that P&L

projections typically take into account expected sales, which may be based upon the sales history of comparable books or other works by the same author, production and marketing costs, and the book's expected list price.

38. Defendants deny the allegations of paragraph 38.

39. Defendants deny the allegations of paragraph 39, except Defendants admit that self-published and work-for-hire authors typically do not receive advances.

40. Defendants deny the allegations of paragraph 40, except Defendants admit that Penguin Random House and Simon & Schuster compete with each other and with many other publishers to acquire rights to publish books in the United States and that authors who sell U.S. publishing rights can reside anywhere in the world.

41. Defendants deny the allegations of paragraph 41.

42. Defendants deny the allegations of paragraph 42.

43. Defendants deny the allegations of paragraph 43. Defendants further respond that Plaintiff's selective quotation is taken out of context and refer the Court to the document itself.

44. Defendants deny the allegations in the first sentence of paragraph 44. Defendants lack knowledge or information sufficient to admit or deny the remaining allegations of paragraph 44, except admit that publishers, including Penguin Random House and Simon & Schuster, made bids for the memoir of a Grammy-award winning singer in 2019 and that the author ultimately accepted a bid from Simon & Schuster. Defendants further respond that Plaintiff's reliance on this anecdotal evidence is misleading and unreliable and Plaintiff's selective quotation is taken out of context. Defendants refer the Court to the bidding correspondence itself.

45. Defendants lack knowledge or information sufficient to admit or deny the allegations of paragraph 45, except admit that publishers, including Penguin Random House and

Simon & Schuster, made bids on a book proposal based on a Broadway play in mid-2019 and that the author ultimately accepted a bid from Penguin Random House. Defendants further respond that Plaintiff's reliance on this anecdotal evidence is misleading and unreliable and Plaintiff's selective quotation is taken out of context. Defendants refer the Court to the bidding correspondence itself.

46. Defendants lack knowledge or information sufficient to admit or deny the allegations of paragraph 46, except admit that publishers, including Penguin Random House and Simon & Schuster, made bids for a book on the Mueller investigation in mid-2019 and that the author ultimately accepted a bid from Penguin Random House. Defendants further respond that Plaintiff's reliance on this anecdotal evidence is misleading and unreliable and Plaintiff's selective quotations are taken out of context. Defendants refer the Court to the bidding correspondence itself.

47. Defendants lack knowledge or information sufficient to admit or deny the allegations of paragraph 47, except admit that publishers, including Penguin Random House and Simon & Schuster, made bids for a book on gender inequality in 2020 and that the author ultimately accepted a bid from Penguin Random House. Defendants further respond that Plaintiff's reliance on this anecdotal evidence is misleading and unreliable and Plaintiff's selective quotations are taken out of context. Defendants refer the Court to the bidding correspondence itself.

48. Defendants lack knowledge or information sufficient to admit or deny the allegations of paragraph 48. Defendants further respond that Plaintiff's reliance on this anecdotal evidence is misleading and unreliable.

49. Defendants lack knowledge or information sufficient to admit or deny the allegations of paragraph 49, except admit that publishers, including Penguin Random House and Simon & Schuster, made bids for a book on the opioid epidemic in early 2020 and that the author ultimately accepted a bid from Penguin Random House. Defendants further respond that Plaintiff's reliance on this anecdotal evidence is misleading and unreliable.

50. Defendants deny the allegations in the first, second, and last sentences of paragraph 50, except Defendants admit that smaller publishers are competitive alternatives for *all* authors. Defendants lack knowledge or information sufficient to admit or deny the allegations in the third and fourth sentences of paragraph 50. Defendants further respond that Plaintiff's reliance on this anecdotal evidence is misleading and unreliable.

51. Defendants deny the allegations of paragraph 51.

52. Defendants deny the allegations of paragraph 52.

53. Defendants deny the allegations of paragraph 53, except Defendants admit the allegations included in the last two sentences of paragraph 53. Defendants further respond that Random House (before its merger with Penguin) was not alleged to have conspired with Apple.

54. Defendants deny the allegations of paragraph 54.

55. Defendants deny the allegations of paragraph 55, except Defendants admit that Penguin Random House and Simon & Schuster provide distribution services to some third-party publishers.

56. Defendants deny the allegations of paragraph 56, except Defendants admit that the proposed acquisition would generate synergies. Defendants further respond that Plaintiff's selective quotations are taken out of context and refer the Court to the documents and testimony themselves.

57. Defendants deny the allegations of paragraph 57. Defendants further respond that Plaintiff's selective quotations are taken out of context and refer the Court to the documents and testimony themselves.

58. Defendants deny the allegations of paragraph 58, except Defendants admit that Penguin Random House has announced that after the merger it will allow Penguin Random House imprints and legacy Simon & Schuster imprints to continue bidding against one another up to a certain amount.

59. Defendants deny the allegations of paragraph 59.

60. Defendants deny the allegations of paragraph 60.

61. Defendants deny that Plaintiff is entitled to any of the relief requested and request that they be awarded the costs incurred in defending this action, as well as any and all other relief the Court may deem just and proper.

DEFENSES

Defendants assert the following defense, without assuming the burden of proof on such defense that would otherwise rest with Plaintiff:

1. Without prejudice to Defendants' response to Paragraph 56, the overwhelming efficiencies that will result from the transaction will benefit authors and consumers, such that the transaction is in the public interest.

Dated: February 16, 2022

Respectfully submitted,

By: */s/ Daniel M. Petrocelli*

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UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

UNITED STATES OF AMERICA, *Plaintiff,* v. **BERTELSMANN SE & CO. KGaA, PENGUIN RANDOM HOUSE, LLC, VIACOMCBS, INC., and SIMON & SCHUSTER, INC.,** *Defendants.*	**Civil Action No. 21-2886-FYP**

AMENDED MEMORANDUM OPINION

John Steinbeck famously said, "I guess there are never enough books." He apparently meant that in the figurative sense, as a comment on the power of books to educate, to enrich, and to explore. But today, his statement also rings true in the economic sense: The retail market for books in the United States was over $11.5 billion in 2019 and has only continued to expand. People want to read. And book publishers have the enormous power and responsibility to decide which books — and therefore which ideas and stories — will be made broadly available to the public. A publishers' marketplace of ideas is also a marketplace of book sales, production costs, and market share. It is this commercial market, so inextricably intertwined with the intellectual life of our nation, that the Court examines in this case.

Penguin Random House ("PRH") is by far the largest book publisher in the United States. Owned by Bertelsmann SE & Co. KGaA ("Bertelsmann"), an international media and services company, PRH annually publishes over 2,000 new books in the U.S. and generates nearly $2.5 billion in revenue. Simon & Schuster, Inc. ("S&S"), owned by the media giant Paramount

Global (formerly ViacomCBS), is the third-largest publisher in the U.S. S&S publishes about 1,000 new titles yearly and reported over $760 million in net sales in 2020.

In March 2020, ViacomCBS announced that it planned to sell S&S. Following a multi-round bidding process, Bertelsmann and PRH signed an agreement with ViacomCBS and S&S in November 2020 to purchase S&S for $2.175 billion. The acquisition of S&S would cement PRH's position as the "number one" publisher in the United States, increasing its retail market share to almost three times that of its closest competitor.[1] Trial Tr. at 741:17–742:4 (Dohle).

In November 2021, the Antitrust Division of the United States Department of Justice ("the government") brought this action against PRH, S&S, and their parent companies ("the defendants"), seeking to block the merger of PRH and S&S under Section 7 of the Clayton Act. The government's case sounds in "monopsony," a market condition where a buyer with too much market power can lower prices or otherwise harm sellers. Essentially, the government alleges that the merger will increase market concentration in the publishing industry, which will allow publishing companies to pay certain authors less money for the rights to publish their books.

The case proceeded to trial on August 1, 2022. For twelve days, the Court heard evidence and argument about how PRH's acquisition of S&S would affect competition in the "upstream" market for publishing rights. The Court heard testimony from authors, publishers,

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[1] In 2019, PRH had a [redacted] percent share of the market for U.S. book sales and S&S had a [redacted] percent share. *See* ECF No. 177 (United States' Sealed Corrected Proposed Findings of Fact and Conclusions of Law ("Govt. PFOF-PCOL")) ¶ 13 (citing Defendants' Exhibit No. DX") 105 at 64); *see also* ECF No. 184 (government's redacted post-trial brief). Thus, the combined entity would have a market share of approximately [redacted] percent. The merged company's next closest competitor would be [redacted] which had an [redacted] percent share of the market for book sales in 2019. *See* Govt. PFOF-PCOL ¶ 13 (citing DX 105 at 64).

literary agents, and industry executives, and admitted over 230 exhibits.[2] After a thorough review of the record and careful consideration of the parties' arguments, the Court concludes that PRH's acquisition of S&S is likely to substantially lessen competition to acquire "the publishing rights to anticipated top-selling books," which comprise the relevant market in this case. The Court therefore will enjoin the proposed merger of PRH and S&S.

I. BACKGROUND

A. The Industry

The book industry is dominated by five major publishing houses — PRH, HarperCollins Publishers, S&S, Hachette Book Group, and Macmillan Publishing Group, LLC — which are known as the "Big Five." Together, the Big Five held nearly 60 percent of the market for the sale of trade books in 2021 (*i.e.*, books intended for general readership, as opposed to specialized books like textbooks or manuals). *See* DX 382; PX 663 at 92.

[2] The Court appreciated hearing the testimony of many dedicated professionals who work in the publishing industry. The Court heard from authors Charles Duhigg, Stephen King, and Andrew Solomon. Publisher witnesses included: Jennifer Bergstrom, Senior Vice President and Publisher of the S&S imprint Gallery Books Group ("Gallery"); Sally Kim, Senior Vice President and Publisher of the PRH imprint G.P. Putnam's Sons ("Putnam"); Liate Stehlik, President and Publisher of Morrow Group, HarperCollins Publishers; and Brian Tart, President and Publisher of the PRH imprint Viking Penguin ("Viking"). The following literary agents testified: Elyse Cheney, Christy Fletcher, Ayesha Pande, Gail Ross, Jennifer Rudolph Walsh (expert witness), and Andrew Wylie. The Court also heard from top industry executives, including Markus Dohle, CEO of PRH; Dennis Eulau, Executive Vice President and COO of S&S; John Glusman, Vice President and Editor in Chief of W.W. Norton & Company ("Norton"); Michael Jacobs, President and CEO of Abrams Books; Jonathan Karp, President and CEO of S&S; Madeline McIntosh, CEO of PRH in the U.S.; Brian Murray, CEO of Harper Collins Publishers; Michael Pietsch, CEO of Hachette Book Group; Don Weisberg, CEO of Macmillan Publishers; and Steven Zacharius, CEO of Kensington Books. The government's economic expert was Dr. Nicholas Hill, and the defendants' economic expert was Professor Edward Snyder. Finally, Adriana Porro, a statistician for U.S. Department of Justice, Antitrust Division, also testified.

The following witnesses testified by video: Christy Fletcher, John Glusman, Michael Jacobs, Andrew Solomon, Liate Stehlik, and Steven Zacharius. *See* Government's Exhibit No. ("PX") 2008 (Fletcher Dep.); Trial Tr. at 1740:16–17 (noting that video of Fletcher's deposition was played at trial); DX 422 (Glusman Dep.); DX 423 (Glusman sealed); Trial Tr. at 1880:4 (noting that video of Glusman's deposition was played at trial); PX 2005 (Jacobs Dep.); Trial Tr. at at 701:13–23 (noting that video of Jacobs's deposition was played at trial); PX 2004 (Solomon Dep.); Trial Tr. at 689:7–8 (noting that video of Solomon's deposition was played at trial). PX 2002 (Stehlik Dep.) at 64–65; Trial Tr. at 628:23 (noting that video of Stehlik's deposition was played at trial); PX 2000 (Zacharius Dep.); Trial Tr. at 385:11 (noting that video of Zacharius's deposition was played at trial).

The Big Five have achieved their market dominance in part by acquiring other publishers, contributing to a trend toward consolidation in the industry. Bertelsmann entered the U.S. publishing market by acquiring Bantam Books in 1977, which merged with Doubleday Dell in 1986 and with Random House in 1998. PRH itself was formed in 2013 when Random House acquired Penguin Books. Since 2013, PRH has continued to acquire other publishers, including Sasquatch Books, Rodale, Little Tiger, F&W Media, and Sourcebooks. Meanwhile, Hachette has acquired several independent publishers in the last decade, such as Workman Publishing, Worthy, Perseus, and Black Dog & Leventhal. *See* Trial Tr. at 102:13–103:4 (Pietsch), 204:3–19 (Pietsch). In 2021, HarperCollins acquired Houghton Mifflin Harcourt, which previously was one of the largest among the mid-size, independent publishers. *See* Trial Tr. at 1386:12–17 (Murray), 192:6–193:15 (Pietsch). The remaining Big Five publisher, Macmillan, has pursued organic growth. *See* Trial Tr. at 1079:23–1080:18 (Weisberg).

Some smaller publishers are well respected in the industry and compete against the Big Five — in both the upstream market for acquiring books for publication and in the downstream market for selling books to consumers. For instance, Scholastic is one of the largest children's book publishers and works with some of the same authors as the Big Five, *see* Trial Tr. at 118:20–22 (Pietsch), 545:10–547:2 (Karp); while Kensington, one of the largest remaining independent publishers, is a prominent purveyor of romance novels. *See* PX 2000 (Zacharius) at 8; PX 2002 (Stehlik) at 64–65. In addition, Norton is a prestigious publishing house specializing in narrative nonfiction and is favored by some best-selling authors like Michael Lewis. *See* Trial Tr. at 540:24–541:24 (Karp), 544:17–25 (Karp), 550:22–551:4 (Karp); DX 422 at 7. Other players in the industry include well capitalized, mid-sized publishers like Amazon and Disney, which each bring in over $100 million in annual revenues from publishing. *See* Trial Tr. at 737:22–738:11 (Dohle).

Each publishing company is organized as an umbrella organization that houses various "imprints." An imprint is a trade name or brand name for an editorial group. Imprints specialize in publishing certain types of books and thus develop reputations for success in particular genres. *See* PX 530 at 2. The editors within each imprint select and acquire manuscripts for publication; and then collaborate with authors to develop and finalize their books. *See* Trial Tr. at 97:1–6 (Pietsch), 1915:10–25 (Duhigg), 1919:8–1920:3 (Duhigg). PRH has close to 100 U.S. publishing imprints within six publishing divisions. *See* Trial Tr. at 812:5–11 (Dohle); Govt. Demo. 1 (PRH organizational chart). Its best-known imprints include Viking, Penguin Press, Doubleday, Riverhead, Random House, and Putnam. S&S operates three publishing groups with around 50 imprints, including Simon and Schuster, Atria Books, Scribner, and Gallery Books. *See* PX 663 (materials for prospective S&S buyers) at 91, 101.

All publishers and editors are highly motivated to secure the rights to publish new books; indeed, identifying and acquiring books that people want to read is the essence of the business. Yet only 35 out of 100 books turn a profit, and breakout titles drive revenues — the top 4 percent of profitable titles generate 60 percent of profitability. *See* PX 151 (presentation by PRH executives on publishing industry) at 11; Trial Tr. at 747:16–18 (Dohle), 2289:2–10 (McIntosh) ("*Where the Crawdads Sing* is a great current example. *Fifty Shades of Grey*, *Gone Girl*, *Girl on the Train*. . . . [their] sales performance so outstrips our expectation, that they deliver most of the profit to the company."). Publishing has therefore been described by insiders as a "portfolio business": The business model is to acquire a large number of high-quality books, knowing that a substantial percentage of the titles will not be profitable. *See* Trial Tr. at 747:5–9 (Dohle). As

PRH CEO Markus Dohle put it, publishers are "angel investors" that "invest every year in thousands of ideas and dreams, and only a few make it to the top." *Id.* at 747:5–9. The books that do "make it to the top" and sell well, especially over a number of years, allow the companies to take risks in acquiring new books and enable publishers to manage the uncertainty inherent in "betting" on new titles. *See id.* at 747:5–7 (Dohle); PX 151 at 11. Books that continue to sell after the first year of publication comprise a publisher's "back list," which can provide an important source of stable revenue. Back lists allow publishers to play the "long game" because some books take a while to become profitable. *See* PX 2004 at 55. By contrast, the "front list," which consists of books not yet released or on the market for under a year, is risky and has poorer margins, due to the expenses of marketing and roll-out associated with the new titles. *See* Trial Tr. at 118:15–119:11 (Pietsch).

B. Acquiring Books for Publication

Books begin, of course, with authors. Authors often spend years developing their ideas, conducting research, and refining their manuscripts or proposals before submitting them for publication. A project that is acquired may still take months or years of work before it becomes a completed book that is ready for distribution. *See, e.g.*, *id.* at 1916:14–21 (Duhigg). To support themselves, authors often rely on "advances" from their publishers. *See id.* at 1925:15–22 (Duhigg), 1941:9–1943:1 (Duhigg) (advance allowed him to take time off from his job to write, support his newborn child, buy a house, and pay living expenses). An advance is an upfront payment against the royalties that an author may earn in the future.[3] The advance is the

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[3] Royalties are payments made to the author based on a book's sales. *See* Trial Tr. at 106:20–107:25 (Pietsch). For example, authors earn 7.5 percent of sales for paperback books. *See id.* at 255:24–256:20 (Pande), 2011:9–10 (Kim). An advance is an upfront payment of those anticipated royalties; the author is not required to pay back the advance even if the book's actual royalties never exceed the amount of the advance. *See id.* at 106:20–107:25 (Pietsch). Advances are paid in installments, typically in quarters. Generally, the first installment is paid upon the signing of the book contract; the second payment is made upon delivery and acceptance of the manuscript;

"single most important" term in a contract for publishing rights because in a "large number of cases, it may be the only compensation that the author will receive for their work." *Id.* at 254:18–24 (Pande); *see also* PX 2002 (Stehlik) at 67. Indeed, most authors do not "earn out" their advances, *i.e.*, ultimately earn royalties that exceed the amount of their advances.[4] In addition to the advance, authors care about working with editors who share their vision for the book and who can help them to "bring the book into the world." Trial Tr. at 97:2–6 (Pietsch); *see also id.* at 1918:5–24 (Duhigg), 1943:13–17 (Duhigg) (editor is "the reason I'm there" at PRH), 2055:10–2056:9 (Cheney), 2063:5–17 (Cheney).

Authors generally are represented by literary agents, who use their judgment and experience to find the best home for publishing a book. They typically begin the process by submitting the book (which might be a full or partial manuscript, or just a proposal) to multiple imprints or editors on a preliminary basis, to gauge the level of interest in the project. *See id.* at 246:11–22 (Pande), 2105:22– 25(Wylie); PX 151 at 5. Agents use their expertise to determine which imprints and editors to target, based on factors such as the kinds of books the imprint previously has published, how effectively they have published those kinds of books, and the ability of the company to pay appropriate compensation. *See* Trial Tr. at 246:9–22 (Pande), 2117:8–2118:25 (Ross). Agents prioritize submitting manuscripts and proposals to Big Five imprints because of their ability to pay; an agent might send out a second round of submissions that includes more smaller publishers if interest among the Big Five is not strong. *See id.* at 246:17–22 (Pande), 248:15–249:10 (Pande). Given the size of PRH and S&S, and the number of

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the third installment is paid upon publication; and the fourth payment is made twelve months later. *See id.* at 777:1–19 (Dohle), 1829:11–15 (Walsh), 255:1–25 (Pande). It can take three to four years for an entire advance to be paid to an author. *See id.* at 255:15–18 (Pande), 777:1–19 (Dohle).

4 *See* Trial Tr. at 108:2–12 (Pietsch) ("Roughly half the time. About half the books we [Hachette] publish earn out their advances."), 254:20–24 (Pande) (20% of authors represented by Pande's agency earned out advance), 1239:25–1240:8 (Hill) (more than 85% of author contracts for anticipated top-selling books never earn out their advance), 2101:3–5 (Wylie) (5% of books he represents earn out their advances).

imprints they represent, some agents "always" submit to multiple PRH imprints and to S&S. *See id.* at 250:10–251:3 (Pande), 260:16–21 (Pande).

Agents try to maximize the advances paid to authors: They not only have a fiduciary duty to achieve the best deal, *see id.* at 494:7–17 (Karp), 1748:21–23 (Walsh), but they also are paid on commission (typically 15 percent of the advance). *See id.* at 245:18–25 (Pande); PX 151 at 5. Indeed, one prominent agent has stated that it is his job to "get an advance that an author doesn't earn out," Trial Tr. at 2100:5–25 (Wylie); while a publisher explained that "typically the most important thing for an agent representing authors [is] to get the most amount of money up front," *see* PX 2002 (Stehlik) at 67.

Other common terms in a book contract include royalty rates, audio rights, and payment structure (*i.e.*, the number and timing of the installments in which an advance is paid). *See* Trial Tr. at 255:11–17 (Pande), 255:24–256:20 (Pande). Yet many of those other terms have become standardized across the industry, making advance levels even more important. For instance, each book format has a standard royalty rate that is rarely altered. *See id.* at 106:20–107:13 (Pietsch).[5] Audio rights are now always included in book contracts and may not be sold separately. *See id.* at 257:14–258:6 (Pande), 622:17–25 (Karp); PX 328 (internal PRH email) at 1–2 ("We have to get those [audio] rights."). Finally, even though authors prefer to receive "frontloaded" advances — payments that are made sooner, and in fewer installments — the industry norm has shifted in the opposite direction, from payouts in thirds to payouts in quarters. *See* Trial Tr. at 254:25–255:3 (Pande), 256:22–25 (Pande), 1829:11–18 (Walsh); [redacted] at 19–20.

[5] Generally, paperback books receive a 7.5-percent royalty rate; e-books and audio or digital downloads receive 25 percent of net sales; and hardcover books get a 10-percent rate for the first 5,000 copies sold, 12.5 percent for copies 5,000 to 10,000, and 15 percent of sales exceeding 10,000 copies. *See* Trial Tr. at 255:24–256:20 (Pande), 2011:4–15 (Kim).

The Court is unconvinced by the testimony of certain defense witnesses who stated that advance levels are not the most important factor in book acquisitions, and that the author's "fit" and comfort level with the editor are more significant. *See* Trial Tr. at 1756:2–1757:8 (Walsh), 1836:5–1837:2 (Walsh), 1935:14–20 (Duhigg), 2055:5–2056:9 (Cheney), 2063:4–17 (Cheney). While that may be true in a small number of cases, books generally are sold to the highest bidder. *See id.* at 2395:2–10 (McIntosh) (underbidder winning an auction is "rare"), 2090:20–23 (Wylie) ("[W]e are picking one that we feel presents the strongest combination of financial terms plus editorial engagement and context for the author."), 2106:1–7 (Wylie) (sold books to the highest bidder about 93% of the time). While the choice of an editor is undoubtedly significant, the agent typically has submitted the book only to a pre-screened list of suitable editors and thus may choose the highest bid from among those editors. *See id.* at 246:1–22 (Pande). The overwhelming weight of the evidence supports the conclusion that advance levels are the primary focus of book acquisitions.

Most books are sold in exclusive negotiations between the agent and a single editor or imprint.[6] Such negotiations come about because (1) a publisher has an "option" from a prior contract with the author, which allows the publisher to take the first look at the author's next project and submit an exclusive bid within a limited period; (2) a publisher is willing to pay a premium to "preempt" the book from being offered to others; (3) an agent approaches a single editor that is a particularly good fit for a book and enters negotiations with that editor and their imprint; or (4) only one imprint is interested after the agent has completed a round of

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6 More than half of books are sold through negotiations. *See* Trial Tr. at 1608:20–1609:1 (Hill) (explaining that 60% of books with advances over $250,000 involve negotiations, with the remaining 40% being auctions); *see also id.* at 478:15–479:1 (Karp) (explaining that less than half of acquisitions are auctions because S&S has "so many repeat authors), 771:11–14 (Dohle) (auctions are "small sliver of the overall deals we do, especially the expensive deals we do"), 1963:20–1964:18 (Kim) (explaining that Putnam imprint buys 80% of books through one-on-one negotiations and attributing the higher percentage to its number of "franchise" authors).

submissions. *See id.* at 475:13–476:10 (Karp), 954:18–955:7 (Tart). Alternatively, an agent might decide to utilize an auction format, which requires imprints to bid against each other to acquire the book. Auctions may be organized in (1) a "round robin" format, where the agent accepts competing bids in several "rounds," eliminates the lowest bidders before proceeding to the next round, and continues until only one bidder remains; (2) a "best bids" format, where all bidders submit their highest bid in a single round; or (3) a hybrid format, such as "better best," where the bidding starts as a "round robin" and then shifts to a final round of "best bids." *See id.* at 111:8–113:4 (Pietsch), 2049:1–19 (Cheney), 2116:10–2117:9 (Ross).

A publisher that hopes to acquire a desirable book must offer a competitive advance to be in the running. Editors and publishers determine how much their imprint is willing to pay for a given book. *See id.* at 97:1–6 (Pietsch). To make that determination, they estimate the profitability of the book by generating a profit and loss statement ("P&L"). Such a statement suggests an appropriate advance after considering (1) the anticipated sales of the book and its expected list price (in various formats); and (2) predicted production and marketing costs. *See* DX 414 (P&L Sheet); Trial Tr. at 915:5–918:21 (Tart). The most important input in a P&L — and the driving force behind the advance offered — is the publisher's estimate of book sales. *See* Trial Tr. at 917:13–16 (Tart) ("the higher . . . sales equate to a higher advance in the P&L"), 110:19–111:1 (Pietsch) (relationship between the level of advance and projected sales is "extremely close"). The sales prediction is based on the demand for comparable titles (referred to as "comp titles" or "comps"), which have similar characteristics to the proposed book in terms of subject matter, literary merit, or author background. Publishers also often confer with their sales, publicity, and marketing teams about expected demand for a book. *See id.* at 842:15–843:10 (Dohle), 914:11–18 (Tart), 1036:13–16 (Tart). But publishers do not rely only on the

P&L to determine an appropriate advance. They also consider factors like the editor's enthusiasm, their relationship with the author, whether the book might win an award, and whether the book is in a growing category — if they really want a book, they will "stretch" beyond what a P&L suggests would be profitable. *Id.* at 969:4–970:14 (Tart), 967:3–10 (Tart).

Publishers' sales estimates, broadly speaking, are reasonably reliable. Ultimately, there is a correlation between high advances and high book sales. Books that sell well tend to have garnered high advances, and books that receive high advances tend to sell well. *See id.* at 749:4–22 (Dohle); PX 151 at 11.

C. The Competition for Books

Regardless of the method used to acquire a book's publishing rights, the amount that is paid is inexorably determined by competition. In an auction, a skillful agent can capitalize on enthusiasm for a book and play bidders off against one another, knowing that a publisher will "bid what . . . [it] need[s] to buy that book" because "it [only] takes one passionate editor at another imprint to win that book away." Trial Tr. at 1965:21–25 (Kim). Although the perceived value of a book is subjective and may vary among editors, there is often a consensus among industry players about which books will be successful. *See id.* at 2108:14–24 (Wylie) ("I think there are recognizable qualities in — in books that people who have been in the business for a long time would easily recognize."), 310:12–24 (Pande) (agent explaining that she treats an anticipated strong seller differently, such as by "sending it out as widely as I possibly can").

It is not uncommon for editors and publishers to experience a "kind of auction fever," in which they change their sales expectations for a book and increase what they are willing to pay for it during a competitive round-robin auction. *Id.* at 180:20–181:11 (Pietsch). "[T]he interest of other parties validates [a publisher's] own sense of what a book is worth." *Id.* The record contains numerous examples of books that sold for unexpectedly high advances and achieved other favorable terms for their authors due to the bidding frenzy incited by competitive auctions. For instance, in a hybrid auction of rounds followed by best bids, [redacted], initially received bids of between $150,000 and $400,000 from four publishers. *See* PX 944-B (Porro bidding summary); Trial Tr. at 923:16–930:18 (Tart) (discussing book's acquisition); PX 320 (emails). After six rounds of bidding, PRH's Viking imprint more than doubled its initial bid and won the book for $775,000 "over stiff competition." PX 39 (email from Tart); *see also* PX 944-B (Porro bidding summary); Trial Tr. at 923:16–930:18 (Tart). At the best-bids stage, Viking decided to "stretch" from its initial bid clearance of $700,000 because "there just is literally no telling what the opponents hold in their hands." PX 326 at 1 (emails between Tart and Viking editor Wendy Wolf). Another example is [redacted] which also benefitted from a rounds auction. *See* PX 948-B (Porro bidding summary). In the first round, there were three bids, ranging from $200,000 to $300,000. *See id.* Yet after five rounds, [redacted] received $535,000 plus a $100,000 bonus. *See id.*; Trial Tr. at 433:24–435:17 (Karp) (discussing bidding process); PX 632 (emails discussing auction). The record contains at least 11 other examples that illustrate the sharp increase in prices engendered by competitive auctions, with advances increasing at least $100,000 by the end of the auction.[7]

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[7] *See* PX 937-B (one-round and best-bid auction with beginning high bid of $375,000 and winning bid of $550,000); PX 938-B (four-round and best-bid auction with beginning high bid of $250,000 and winning bid of $750,000); PX 716 (addressing auction summarized in PX 938-B); Trial Tr. at 435:21–437:19 (Karp) (same); PX 939-B (seven-round auction with beginning high bid of $300,000 and winning bid of $1.5 million); PX 940-B (five-round and best-bid auction with beginning high bid of $400,000 and winning bid of $1.1 million for two books); PX 941-B (eight-round auction with beginning high bid of $550,000 and winning bid of $825,000); PX 947-B (two-round and opportunity-to-improve auction with beginning high bid of $500,000 and winning bid of $600,000 and bonuses for two books); PX 950-B (three-round and best-bid auction with a chance to improve, with beginning high bid of $250,000 and winning bid of $700,000); PX 951-B (best-bid and opportunity-to-improve auction with initial preempt offer of $750,000 and winning bid of $1.1 million); PX 954-B (three-round and best-bid auction with beginning high bid of $750,000 and winning bid of $1.05 million); PX 955-B (one-round auction with opportunity to improve, with beginning high bid of $800,000 and winning bid of $1.5 million); PX 729 (book initially received $750,000 preemptive offer from S&S, went to auction, and then S&S made an offer 10% higher than final auction bid, for offer of $1.1 million); Trial Tr. at 445:5–448:11 (Karp) (addressing book in PX 729).

Competition is also a key factor in one-on-one negotiations, where publishers must offer high advances because they know that the agent always has the option of breaking off negotiations and selling the book on the market. *See* Trial Tr. at 955:11–20 (Tart) (explaining that in one-on-one negotiations "you know there's competition out there"), 1847:1–6 (Bergstorm) ("I assume I am negotiating exclusively, but I always have my competition in my rearview mirror. But it's one on one. And sometimes we don't come to terms, and sometimes they will go to someone else."), 1966:17–24 (Kim) ("[E]ven if it's a one-on-one negotiation . . . we're constantly aware that there's competition . . . ."), 114:21–115:6 (Pietsch). Some publishers consider individual negotiations to be the most challenging way to acquire a book, because "you are basically bidding against the author's expectations and the agent's expectations," and there are "no other market inputs [but] you know there's competition out there." *Id.* at 955:11–20 (Tart). In such situations, agents have bargaining leverage because the threat of taking the book to other publishers always lurks in the background. This is particularly true where a publisher is attempting to preempt the auction process. *See, e.g.*, *id.* at 115:21–116:5 (Pietsch) ("When we're calculating a preempt, we want to bring an advance that we believe the agent will consider a good advance; that they will think, yes, there's a chance that if I take this to auction, I might not get this much or this is the range that it might end up at. And so we try to offer a high advance that we think will be compelling to — to the agent . . . ."); 303:13–15 (Pande) ("So preemptive offers tend to be quite high because it has to incentivize us to be willing to take the book off the table and not offer it in a competitive situation."). As agent Gail Ross stated: "[I]n this business, there's always the other competitor. Whether . . . they're bidding or not, they're always there." *Id.* at 2127:11–13.

Agents often submit a book to more than one imprint within a publishing company, *see id.* at 250:10–251:3 (Pande), and publishers sometimes allow their imprints to bid against one another in auctions. For example, PRH allows competitive bidding between its divisions, so long as there also is an external bidder; but for imprints within the same division, PRH requires the division to submit a "house bid." *See id.* at 769:2–20 (Dohle), 935:20–936:1 (Tart), 943:3–24 (Tart); PX 332 (email from PRH staff to agent explaining imprint bidding rules). A house bid is a single bid made on behalf of more than one imprint from a particular publisher; the house bid allows the agent to choose which imprint to work with, and each imprint might also submit a "pitch," *i.e.*, a letter or memo describing its editorial and other services. *See* PX 2002 (Stehlik) at 75–76. Hachette also allows its imprints to bid against one another if there is an external bidder, *see* Trial Tr. at 239:11–23 (Pietsch), and Macmillan appears to allow some imprint competition, *compare* PX 938-B (showing separate bids from two Macmillan imprints), *with* PX 941-B (showing house bid from Macmillan imprints), *and* PX 954-B (showing one bid from Macmillan imprints). S&S and HarperCollins, however, do not allow competitive bidding among their own imprints but instead require their imprints to submit house bids. *See* Trial Tr. at 463:11–13 (Karp), 600:8–10 (Karp), 2119:11–24 (Ross); PX 2002 (Stehlik) at 75–76. Allowing sibling imprints to compete against each other increases the publisher's chances of winning a title; gives the editors from each imprint the freedom to pursue their desired projects, and allows authors more choice in finding the most "comfortable home" and best editorial match for their books. Trial Tr. at 839:11–840:4 (Dohle).

Although internal competition may yield benefits to publishers and authors, it is not in a publisher's economic interest to allow its own imprints to drive up the price of an acquisition, and publishers therefore take steps to limit internal competition. *See* PX 411 (presentation by

Madeline McIntosh to PRH Board) at 4 (explaining that McIntosh had "[i]ncreased background coordination in auctions to leverage internal demand information better and avoid internal upbidding"); Trial Tr. at 239:11–23 (Pietsch) ("Once we have only Hachette imprints bidding, then . . . continuing to bid each other up would hurt the company's collective P&L."). Ample evidence in the record demonstrates that PRH imprints often coordinate their bids within the same auction, artificially suppressing advances. *See id.* at 2341:9–2345:7 (McIntosh), 2373:9–2382:8 (McIntosh); PX 107 (email from McIntosh) ("I feel we should coordinate — shouldn't be forced into bidding against each other for existing authors"); PX 121 (emails between McIntosh and PRH executive Nina von Moltke) (coordinating imprint bids). For example, PRH imprints sometimes agree to submit the same bid. *See* PX 107 ("We are coordinated. Bill [Knopf Doubleday] and Kara [Random House] will agree to a number and both offer same."). They also sometimes arrange to start their bidding from a lower number. *See* PX 116 (emails between von Moltke and McIntosh) (deciding that PRH imprints "go in a bit lower in round 1"). Finally, PRH imprints sometimes decide to collectively "move up slowly" in their bidding, particularly if PRH is the "main driver of value." PX 336 (email from PRH executive to Tart). PRH appears to take pride in its successful program of bid coordination. *See* PX 421 (email from von Moltke to McIntosh) (discussing auction where three top bids at $600,000 were from PRH imprints and noting she was "[g]lad we didn't go higher (this one definitely benefitted from the coordination!)"). This type of behavior from independent companies would be illegal. *Cf. United States v. Apple, Inc.*, 791 F.3d 290, 339 (2d Cir. 2015).

In competing for the most attractive new books, the Big Five have significant advantages over smaller publishers. Most critically, the Big Five have the capital to take chances and place bigger bets on a book's success; that is, they can offer higher advances for more books. Indeed, agents and authors choose the Big Five because "they are most likely to pay an appropriate advance," *see* Trial Tr. at 246:19–22 (Pande); and at least one mid-size competitor observes that the Big Five often "overpay" for books. *See* DX 422 (Glusman) at 76. The Big Five can afford to take on more risk by paying higher advances because they have the most substantial back lists, which are highly profitable. A book that does not sufficiently earn out its advance is a "loss" for the publisher,[8] but a publisher that has a steady income stream from its back list has a higher tolerance for absorbing such losses. *See* Trial Tr. at 156:5–158:10 (Pietsch), 160:7–161:7 (Pietsch), 1066:22–25 (Weisberg) ("It[] . . . obviously has an impact on the bottom line if [your] unearned advances are too large."). PRH has the largest back list in the industry, and its back list is the most significant source of its revenue. *See id.* at 2358:2–7 (McIntosh).

The Big Five also offer significant advantages in ensuring a book's presence in the media and visibility to its target audience. The Big Five publishers and their individual imprints have teams dedicated solely to selling, marketing, and publicizing books, which have built critical relationships with booksellers and the media. *See* PX 2004 (Solomon) at 64 ("There's just a whole industry that responds better to Big Five publishers."); Trial Tr. at 259:13–260:4 (Pande), 840:5–841:12 (Dohle), 983:12–25 (Tart). Big Five publicity teams "engage with the media to promote the book." Trial Tr. at 1047:16–20 (Tart). Those teams can secure author interviews on prominent programs like the Today Show, Good Morning America, or NPR, and can persuade senior book reviewers to closely read and review the book. *See* PX 2004 (Solomon) at 63–64.[9]

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8 A book need not earn out its entire advance for a publisher to profit; publishers begin to profit "at around 70 percent of earnout for most books." *See* Trial Tr. at 1240:9–12 (Hill), 2258:21–25 (McIntosh).

9 *See* PX 2004 (Solomon) at 63–64. ("You know, your book comes out and what do you want; you want to be on NPR, you want to be on Good Morning America or the Today Show, you want to . . . do a radio interview with Terry Gross. . . . The publishers at the Big Five houses have more ready access to all of that. And . . . if there is a new book that [S&S imprint] Scribner said is a really major title, it will at least be closely read by the editors of

The Big Five's sales teams can help ensure that stores not only buy books but place them in prominent displays. *See* Trial Tr. at 174:19–175:5 (Pietsch), 1372:11–25 (Murray), 1378:4–1379:9 (Murray); PX 2002 (Stehlik) at 112 ("I would say generally the Big Five seem to have more visibility in stores . . . than other smaller publishers."). The Big Five edge extends to the virtual marketplace; for instance, PRH hires data scientists to study Amazon's search algorithms and spends money to get books better positioned in Amazon's search results. *See* Trial Tr. at 893:6–16 (Dohle); PX 2002 (Stehlik) at 112.

Meanwhile, marketing teams are responsible for paid advertising and use "every device possible to find that [book's] audience." *See* Trial Tr. at 1067:17–1068:14 (Weisberg). In service of that goal, they produce market research and data analytics, as well as send marketing materials to traditional outlets or social media influencers. *See id.* at 983:12–25 (Tart), 1849:13–25 (Bergstrom), 1938:5–12 (Duhigg). The Big Five can even ensure that books look better when they reach an audience, providing multiple versions of cover art for an author to choose from. *See* PX 2001 (Zacharius) at 37 ("[redacted] Trial Tr. at 1920:4–13 (Duhigg) ("[Random House] came up with something like 13 or 15 different mockup book jackets to try and figure out like which one is going to attract the reader's eyes when it's sitting there on a shelf and get them to pick it up.").

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book reviews in a way that a book coming from a more obscure press is likely to go to a junior reader"); Trial Tr. at 1047:16–20 (Tart), 167:17–168:9 (Pietsch) ("And so to get [the media] to pay attention to your emails or return your phone calls or come out to lunch or come to your pitch event, it takes a long time in developing a lot of credibility."), 1372:11–25 (Murray) ("And then we have publicists who have relationships with television and radio producers.").

By contrast, smaller publishers might have a handful of staff doing all the editing, marketing, publicity, and sales work on a book. *See id.* at 259:13–260:4 (Pande). Although some of their books do well, that success is harder won and less frequent. *See* PX 2004 (Solomon) at 64 ("[T]here's some fabulous books that are published by other houses and some of them end up being successful. But it's harder when you have fewer resources. It's easier when you have more resources."). Authors want the easy advantages offered by the Big Five's strong publicity, marketing, and sales teams.[10] Authors know that "when a publisher really gets behind a book, particularly a big publisher, the chances are that that book is going to probably succeed on some level." *See* Trial Tr. at 335:23–336:1 (King).

Successful authors who first publish with smaller publishers often prefer to publish their next book with a Big Five publisher. *See id.* at 291:10–292:25 (Pande). Along with their substantial resources, Big Five publishers have developed a valuable reputation for having strong editorial staff with experience working with the best books and authors. *See* PX 530 at 2 (opining that Big Five "are known for their strong editorial . . . skills").[11] Thus, a second book with a Big Five publisher gives the author a better chance of an even bigger success. *See* Trial Tr. at 291:10–292:25 (Pande). The Big Five view the smaller publishers as a "farm team" for spotting writing talent, and routinely lure authors away from the non-Big Five publishers with higher advances and the promise of superior marketing, distribution, and even cover design. *See*

[10] *See* PX 2002 (Stehlik) at 101 ("Most authors want to have their books in as many locations as possible."), 112 (suggesting that visibility is one reason "why many agents and authors prefer to go with bigger publishers").

[11] *See also* Trial Tr. at 353:8–25 (Eulau) (acknowledging that "reputation is important" for attracting authors), 454:11–22 (Karp) (agreeing that S&S's decades of credibility and success attracts authors), 535:7–20 (Karp) (noting that a Macmillan imprint has "a long reputation, so they can claim that when they publish a writer, that writer will be following in the tradition of other great award-winning Nobel laureates"), 1375:24–1376:23 (Murray) ("[To acquire top authors,] [y]ou have to have . . . expertise and a reputation. It helps if you have published authors that are publishing to the similar readers, you know, so you can point to similar books that maybe you published one, two, or three years ago that were successful."), 2005:15–2006:18 (Kim) ("[A]uthors want to be published by publishers with good reputations, good standing, you know, with booksellers and media. They want to be a part of a list that they can be proud to say they're a part of.").

PX 530 at 2 (explaining that small publishers "become farm teams for authors who then want to move to a larger, more financially stable major publisher"); Trial Tr. at 291:10–292:25 (Pande), 335:412 (King) (describing smaller publishers as the "minor leagues for writers"). The trial record contains many examples of authors who moved from non-Big Five publishers to the Big Five after establishing a track record of success. *See* Trial Tr. at 292:6–12 (Pande) ("I have had several authors who have moved from small publishers to larger publishers. One of the authors' name is Lad[ee] Hubbard. Her first book was published by Melville House. And for her second book, she moved to [HarperCollins]. My author Lisa Ko moved from Algonquin to Penguin Random House."); DX 423 (Glusman) at 15–19 ([redacted] Of course, there are exceptions, as the defendants point out. *See, e.g.*, ECF No. 178 (Defendants' Sealed Proposed Findings of Fact) ¶ 70 (citing PX 2001 (Zacharius)) ([redacted] *see also* ECF No. 182 (Defendants' Redacted Proposed Conclusions of Law) ¶¶ 9–10).[12]

Self-publishing is not a significant factor in the publishing industry. Self-published books are rarely published in print and are typically limited to online distribution. *See* Trial Tr. at 173:13–23 (Pietsch), 1108:2–9 (Weisberg). The authors of self-published books cannot pay themselves an advance. *See id.* at 173:8–15 (Pietsch) (remarking that for advances above $100,000, "I do not consider [self-publishing] a threat at all because . . . [s]elf-published authors

[12] Defendants proposed conclusions of fact and law are contained in the same document (ECF No. 178) but are separately enumerated. The Court will refer to the proposed conclusions of fact as "Defs. PFOF" and proposed conclusions of law as "Defs. PCOL."

can't pay themselves an advance against royalties"). Moreover, individual authors generally do not have relationships with media or distributors necessary to ensure that their books are visible to a potential audience. *See id.* at 173:13–23 (Pietsch) ("Self-published authors . . . don't have the ability to attract the attention of media. . . . Imagine how hard it is . . . for one person who has a book they published entirely on their own to say: Give me your attention. Review my book. Promote my book. And so they simply don't have access to the general-interest market that we and the other Big 5 publishers address routinely. That's our business."). In short, self-publishing cannot compete with the experience and resources of publishing companies. *See id.* at 173:13–174:2 (Pietsch); PX 2004 (Solomon) at 52–53 ("I think a commercial publisher sells more books, garners more reviews, gains more attention, does all kinds of things. . . . I [as an author] don't have all of those business competencies that are involved."); *see also* Trial Tr. at 2898:8–18 (Snyder) (positing that "self-publishing is not a relevant constraint").

II. LEGAL STANDARDS

Section 7 of the Clayton Act prohibits mergers and acquisitions "where in any line of commerce or in any activity affecting commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition." 15 U.S.C. § 18. The "fundamental purpose" of Section 7 is "to arrest the trend toward concentration, the tendency to [monopoly or monopsony], before the [buyer's or seller's] alternatives disappear[] through merger . . . ." *United States v. Phila. Nat'l Bank*, 374 U.S. 321, 367 (1963). Thus, Congress "sought to assure . . . the courts the power to brake this force at its outset and before it gathered momentum."

Brown Shoe Co. v. United States, 370 U.S. 294, 317–18 (1962).[13]

To this end, "Congress used the words *may* be substantially to lessen competition to indicate that its concern was with probabilities, not certainties." *FTC v. H.J. Heinz Co.*, 246 F.3d 708, 713 (D.C. Cir. 2001) (emphasis in original) (cleaned up) (quoting *Brown Shoe*, 370 U.S. at 323). The government "must prove the alleged Clayton Act violation by a preponderance of the evidence," *i.e.*, that the merger would more likely than not violate the statute; but "'[S]ection 7 does not require proof that a merger or other acquisition will cause higher prices [or anticompetitive effects] in the affected market. All that is necessary is that the merger create an appreciable danger of such consequences in the future.'" *United States v. Anthem, Inc.*, 236 F. Supp. 3d 171, 192 (D.D.C. 2017) (first quoting *United States v. SunGard Data Sys., Inc.*, 172 F. Supp. 2d 172, 180 (D.D.C. 2001); and then quoting *Hosp. Corp. of Am. v. FTC*, 807 F.2d 1381, 1389 (7th Cir. 1986)).[14] Section 7's probabilistic standard "creates a relatively expansive definition of antitrust liability" and "subjects mergers to searching scrutiny." *California v. Am. Stores Co.*, 495 U.S. 271, 284 (1990).[15]

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13 The government's theory is that the combined defendants would exercise market power on the buy-side of the publishing market, *i.e.*, monopsony. Although most antitrust law has developed under sell-side theories of harm, *i.e.*, monopoly, monopsony analysis relies on similar principles. Under the Horizontal Merger Guidelines, discussed *infra* at n.15, "to evaluate whether a merger is likely to enhance market power on the buying side of the market, the Agencies employ essentially the framework described . . . for evaluating whether a merger is likely to enhance market power on the selling side of the market." U.S. Dep't of Justice & Fed. Trade Comm'n, Horizontal Merger Guidelines § 12 (2010), https://www.justice.gov/sites/default/files/atr/legacy/2010/08/19/hmg-2010.pdf ("Merger Guidelines"). "The kinship between monopoly and monopsony suggests that similar legal standards should apply to claims of monopolization and to claims of monopsonization." *Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co.*, 549 U.S. 312, 321–22 (2007). "Monopsony and monopsony power are the equivalent on the buying side of monopoly and monopoly power on the selling side." *United States v. Syufy Enters.* 903 F.2d 659, 663 n.4 (9th Cir. 1990) (quotations omitted).

14 Although defendants quote *United States v. Marine Bancorporation*, 418 U.S. 602, 623 n.22 (1974), for the proposition that a merger's anticompetitive effects must also be "imminent" to violate the Clayton Act, *see* Defs. PCOL ¶ 1, the full quotation from that case is that "the loss of competition 'which is *sufficiently* probable and imminent' is the concern of § 7," *Marine Bancorp.*, 418 U.S. at 623 n.22 (emphasis added) (citation omitted). The Court understands that description of the standard to be functionally indistinguishable from the D.C. Circuit's formulation of the Section 7 standard, as described above.

15 In *United States v. AT&T, Inc.*, the D.C. Circuit described the Section 7 standard of proof as follows: "[T]he government must show that the proposed merger is likely to substantially lessen competition, which

Although "Congress neither adopted nor rejected specifically any particular tests for measuring the relevant markets [where commerce is affected] . . . [n]or [defined] . . . the word 'substantially,'" *Brown Shoe*, 370 U.S. at 320–21, the D.C. Circuit has taken a burden-shifting approach to Section 7 cases. *See AT&T, Inc.*, 916 F.3d at 1032; *Heinz*, 246 F.3d at 715; *United States v. Baker Hughes Inc.*, 908 F.2d 981, 982–83 (D.C. 1990). The *Baker Hughes* test, as it has come to be known, has a preliminary requirement and three steps. At the threshold, the government must demonstrate the existence of a relevant market. *See Marine Bancorp.*, 418 U.S. 602, 618 (1974); *FTC v. RAG-Stiftung*, 436 F. Supp. 3d 278, 291–92 (D.D.C. 2020). Once it has done so, the first step of the test allows the government to establish a prima facie case and a presumption of anticompetitive effects by demonstrating undue concentration within that relevant market. *See Anthem*, 855 F.3d at 349; *Heinz*, 246 F.3d at 715. The second step shifts the burden to the defendants, who must demonstrate in rebuttal that real-world conditions make market concentration alone an unreliable predictor of the merger's anticompetitive effects. *See Anthem*, 855 F.3d at 349–50; *Heinz*, 246 F.3d at 715. If the defendants successfully rebut the prima facie case, the burden shifts back to the government in the third step "and merges with the

encompasses a concept of 'reasonable probability.'" 916 F.3d 1029, 1032 (D.C. Cir. 2019) (emphasis deleted) (quoting *Brown Shoe*, 370 U.S. at 323 n.39). The parties dispute the meaning of this language. The defendants argue that *AT&T* "require[s the government] to prove that a merger is 'likely' to cause substantial harm to competition, [not] only that harm 'may' occur." Defs. PCOL ¶ 2. The government points to *AT&T*'s explanation "that this standard encompasses a concept of 'reasonable probability,'" arguing that *AT&T* requires something less than what the defendants propose. *See* Govt. PFOF-PCOL ¶¶ 38, 40; *see also id.* ¶ 38 (arguing for an "appreciable danger" standard). The root of these competing formulations may be uncertainty over how the government's preponderance-of-the-evidence burden interacts with Section 7's already probabilistic standard; combined, the two standards require the government to prove "by a preponderance of the evidence" that the effect of a challenged merger or acquisition "may be substantially to lessen competition." *Anthem*, 236 F. Supp. 3d at 192. Like the district court in *AT&T*, this Court "need not further toil over discerning or articulating the daylight, if any, between 'appreciable danger,' 'probable,' 'reasonably probable,' and 'likely' as used in the Section 7 context." *United States v. AT&T*, 310 F. Supp. 3d 161, 189 n.16 (D.D.C. 2018). The selection of any of the competing permutations is not outcome-determinative in this case.

ultimate burden of persuasion, which remains with the government at all times." *Baker Hughes*, 908 F.2d at 983; *accord Anthem*, 855 F.3d at 350.

III. ANALYSIS

The government contends that the merger of PRH and S&S would harm competition to acquire the publishing rights to "anticipated top-selling books," resulting in lower advances for the authors of such books and less favorable contract terms. The defendants do not dispute that if advances are significantly decreased, some authors will not be able to write, resulting in fewer books being published, less variety in the marketplace of ideas, and an inevitable loss of intellectual and creative output. *See* Trial Tr. at 772:8–25 (Dohle). The defendants vigorously contest, however, whether advances would decrease after the merger: They contend that competition would not be harmed and that advances would actually rise.

A. Market Definition

The first step in merger analysis is the identification of a relevant market. *See Marine Bancorp.*, 418 U.S. at 618. Market definition "helps specify the line of commerce and section of the country in which the competitive concern arises"; and allows the Court to evaluate any anticompetitive effects by "identify[ing] market participants and measur[ing] market shares and market concentration." Merger Guidelines § 4.[16] "Determination of the relevant market is a necessary predicate to a finding of a violation of the Clayton Act because the threatened monop[sony] must be one which will substantially lessen competition 'within the area of effective competition.'" *United States v. E.I. du Pont de Nemours & Co.*, 353 U.S. 586, 593

[16] The Merger Guidelines "outline the principal analytical techniques, practices, and the enforcement policy of the Department of Justice and the Federal Trade Commission" for merging competitors under federal antitrust laws. Merger Guidelines § 1. They "describe the principal analytical techniques and the main types of evidence on which the Agencies usually rely to predict whether a horizontal merger may substantially lessen competition." *Id.* Although the Merger Guidelines are not binding, courts have consistently looked to them for guidance in merger cases. *See, e.g.*, *FTC v. Sysco Corp.*, 113 F. Supp. 3d 1, 38 (D.D.C. 2015).

(1957) (quoting *Standard Oil Co. of Cal. v. United States*, 337 U.S. 293, 299 n.5 (1949)). But defining a relevant market is not an end unto itself; rather, it is an analytical tool used to ascertain the "locus of competition." *Brown Shoe*, 370 U.S. at 320–21; *see also* Merger Guidelines § 4.1.1 ("[T]he purpose of defining the market and measuring market shares is to illuminate the evaluation of competitive effects."). Accordingly, the Supreme Court has emphasized that market definition under the Clayton Act was intended by Congress to be "a pragmatic, factual" analysis and "not a formal, legalistic one." *Brown Shoe*, 370 U.S. at 336.

Market definition has two components: the relevant geographic market and the relevant product market. *See Brown Shoe*, 370 U.S. at 324; *Anthem*, 236 F. Supp. 3d at 193. Here, the parties agree that the relevant geographic market is the global market for the acquisition of U.S. publishing rights. *See* Govt. PFOF-PCOL ¶ 125; ECF No. 1 (Complaint) ¶ 40; ECF No. 56 (Amended Answer) ¶ 40 (agreeing "that Penguin Random House and Simon & Schuster compete with each other and with many other publishers to acquire rights to publish books in the United States and that authors who sell U.S. publishing rights can reside anywhere in the world."). The parties strenuously dispute, however, the boundaries of the appropriate product market.

The government defines the relevant product market as the one for publishing rights to anticipated top-selling books. *See* Govt. PFOF-PCOL ¶¶ 15, 63. Anticipated top-selling books are those that are expected to yield significant sales, and for which authors therefore receive higher advances. *See id.* ¶ 15. The government contends that such books have distinctive characteristics, including the need for extra marketing, publicity, and sales support to allow them to reach broader audiences. *See id.* ¶¶ 15, 64–68, 87, 93–119.

The proposed market for anticipated top-selling books is a submarket of the broader publishing market for all trade books. *See id.* ¶ 124; *see also* Defs. PCOL ¶¶ 9–10 (explaining that the "market for the acquisition of *all* U.S. trade books" is an appropriate, broader market). Under the government's monopsony theory, the authors of anticipated top-selling books are "targeted sellers" against whom the merged defendants might lower the prices paid for the authors' wares. *See* Govt. PFOF-PCOL ¶¶ 55–58, 69–76; *see also* Merger Guidelines § 4.1.4 (If a monopsonist could "profitably target a subset of [sellers] for price [de]creases, the [government] may identify relevant markets defined around those targeted [sellers]."); *cf. FTC v. Wilh. Wilhelmsen Holding ASA*, 341 F. Supp. 3d 27, 46–47 (D.D.C. 2018) ("[A]ntitrust markets can be based on targeted customers"); *Sysco*, 113 F. Supp. 3d at 38–40 (discussing definition of markets based on targeted customers). In the monopsony context, "[a] submarket exists when [buyers] can profitably [cut] prices to certain targeted [sellers] but not to others, in which case regulators may evaluate competitive effects separately by type of [seller]." *Anthem*, 236 F. Supp. 3d at 195 (cleaned up).

Courts evaluate relevant product markets in the monopsony context in two ways: by considering qualitative, "practical indicia" as described by the Supreme Court in the *Brown Shoe* case, 370 U.S. at 325; and by examining "supply substitution" and applying the "hypothetical monopsonist test," which are discussed in detail, *infra*. The parties in this case focus their arguments on whether "practical indicia" support the finding of a market to publish "anticipated top-selling books." Because the parties choose to fight on the battlefield of "practical indicia," that is where the Court begins its analysis.

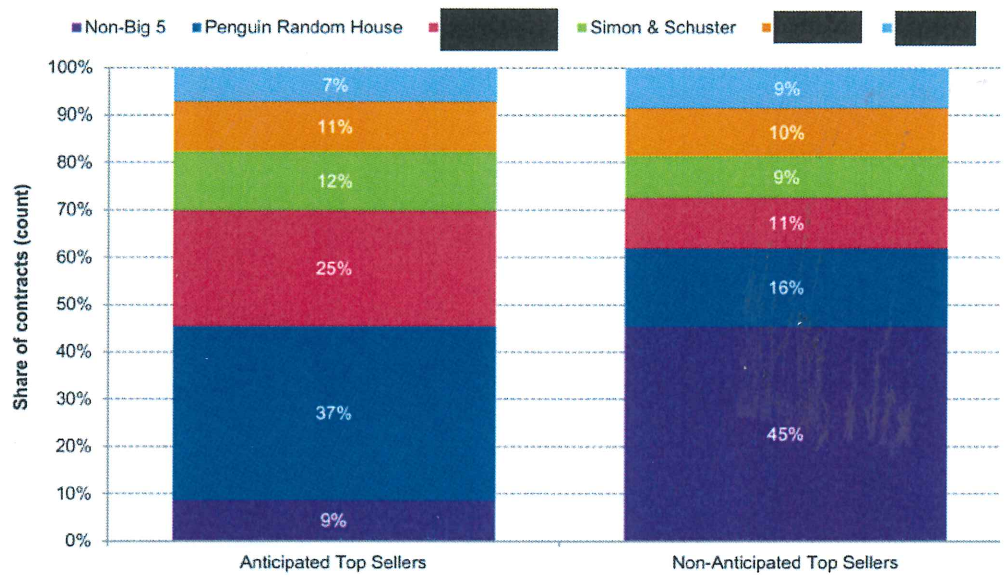
1. Practical Indicia

"[W]ithin [a] broad market, well-defined submarkets may exist which, in themselves, constitute product markets for antitrust purposes. The boundaries of such a submarket may be determined by examining such practical indicia as industry or public recognition of the submarket as a separate economic entity, the product's peculiar characteristics and uses, unique production facilities, distinct [sellers], distinct prices, sensitivity to price changes, and specialized vendors." *Brown Shoe*, 370 U.S. at 325. These indicia are "practical aids" as opposed to "talismanic" criteria "to be rigidly applied," *FTC v. Swedish Match*, 131 F. Supp. 2d 151, 159 (D.D.C. 2000) (cleaned up); thus, "submarkets can exist even if only some of these factors are present." *FTC v. Staples, Inc.*, 970 F. Supp. 1066, 1075 (D.D.C. 1997) ("*Staples I*").

Brown Shoe's practical indicia also may help identify a market of targeted sellers. *See FTC v. Whole Foods Market, Inc.*, 548 F.3d 1028, 1038–39 (D.C. Cir. 2008) (citing *Brown Shoe*, 370 U.S. at 325). For example, a market of "distinct [sellers]," as posited by the government, may find "a particular [set of buyers] 'uniquely attractive'" and "the only realistic choice" for their products. *Id.* (first citing *Brown Shoe*, 370 U.S. at 325; then quoting *Nat'l Collegiate Athletic Ass'n v. Bd. of Regents of the Univ. of Okla.*, 468 U.S. 85, 111 (1984); and then quoting *SuperTurf, Inc. v. Monsanto Co.*, 660 F.2d 1275, 1278 (8th Cir. 1981)).

i. The $250,000 Threshold

To identify the books that are anticipated to sell well, the government focuses on the criterion of "distinct pricing": For analytical purposes, it defines anticipated top-selling books as those for which publishers pay an advance of at least $250,000. *See* Govt. PFOF-PCOL ¶ 64; *Brown Shoe,* 370 U.S. at 325 (explaining that "distinct prices" are probative in market definition); *see also Whole Foods*, 548 F.3d at 1038–39 (explaining distinct prices paid by targeted group of customers "indicate[] the existence of a submarket of core customers"); *Syufy Enters. v. Am. Multicinema, Inc.*, 793 F.2d 990, 995 (9th Cir. 1986) (considering "lucrative terms offered for the pictures by exhibitors" to define relevant market). Books that meet the $250,000-advance threshold comprise only 2 percent of all book acquisitions, but they account for 70 percent of all advance spending, amounting to $1 billion annually. *See* Govt. PFOF-PCOL ¶¶ 15, 68 (citing Trial Tr. at 1239:10–24 (Hill), 2904:17–2905:3 (Snyder)). Government's Exhibit 963 shows that the market shares of industry participants in the proposed publishing market for anticipated top-selling books are far more concentrated than in the market for publishing books at lower advance levels:



Source: Snyder Advance Data.

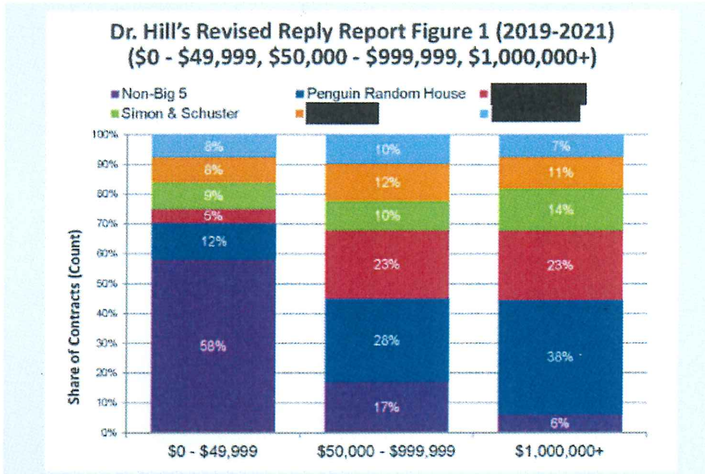
In the publishing market for anticipated top-selling books, the Big Five publishers hold 91 percent of the market share, while smaller publishers collectively hold only 9 percent. PX 963. By contrast, in the publishing market for books that earn advances below $250,000, the non-Big Five publishers have a much more substantial market share of 45 percent. *Id.*

As an initial matter, the government's use of high advances as a proxy for anticipated book sales is logical and supported by market realities. In publishing, advances are correlated with expected sales because books that are expected to sell well receive higher advances. *See supra* Section I.B. In fact, advance levels are set by using P&L's, and the defining feature of a

P&L is the sales estimate. *See id.*; Trial Tr. at 917:13–16 (Tart) ("[T]he higher . . . sales equate to a higher advance in the P&L."). Moreover, industry practices indicate that $250,000 is a reasonable place to draw the line: S&S and two of the three PRH adult divisions require approval from senior publishers or executives for advance offers of $250,000 or more; and *Publishers Marketplace*, a major industry publication, categorizes deals for $250,000 or more as "significant."[17] *See* Trial Tr. at 1233:5–135 (Hill), 459:5–8 (Karp), 1993:1–3 (Kim), 914:22–915:2 (Tart), 2261:12–2262:5 (McIntosh); PX 989 ([redacted]). This evidence is probative of "industry or public recognition" of a distinct category of books that receive advances at or above the $250,000 level. *Brown Shoe*, 370 U.S. at 325.

The defendants take aim at the $250,000 threshold that the government has chosen to bound the market. *See* Defs. PCOL ¶¶ 23–25, 28–41. Most significantly, they argue that the $250,000 threshold is either too high or too low to define a submarket for anticipated top selling books. *Id.* ¶¶ 28–41; Defs. PFOF ¶¶ 33–43. Specifically, the defendants rely on their Exhibit 438 to argue that the advance threshold should be set at $50,000 to capture the point at which the Big Five begin to dominate the market for acquiring books:

17 As for other Big Five publishers, Hachette does not have a company-wide approval policy, but its different imprints require approval for offers from above $100,000 to above $250,000. *See* Trial Tr. at 232:21–233:5 (Pietsch) ("All our publishers have advance approval levels and they are clustered right around [$250,000]."). Hachette also tracks the books it lost for advances of $500,000 or more. *See* PX 790. [redacted]. *See* Trial Tr. at 1438:8–11 (Murray). [redacted] *See id.* at 1101:7–1102:13 (Weisberg); DX 408.



See Defs. PFOF ¶ 37 ("[T]he data establish that *if* competitive conditions differ based on market shares and author preferences, the difference begins with books acquired for advances of $50,000 or more," where the market share of non-Big Five publishers is reduced from 58% to 17%.); Defs. PCOL ¶¶ 31–34. Alternatively, the defendants contend that the threshold should be set at $1 million to identify the books by celebrity, franchise, or award-winning authors that are most clearly destined for success. *See* Defs. PFOF ¶¶ 37–40; Defs. PCOL ¶¶ 35–41. If the relevant market were properly defined at the lower ($50,000) or higher ($1 million) advance level, the defendants urge, the government could not show a sufficient decrease to competition or harm to authors. *See* Defs. PFOF ¶¶ 38, 42–43.

The defendants' excessive concern over the specific dollar threshold betrays a misunderstanding of why the threshold was chosen. The market that the government seeks to define is the one for anticipated top-selling books, and the $250,000 demarcation was adopted only as an analytical tool to help it group together the books in question. The government's economic expert, Dr. Nicholas Hill, also conducted his analyses at other numerical thresholds (including $150,000, $250,000, $500,000, and $1 million) and observed consistent outcomes at those various high-dollar amounts. *See* PX 960; Trial Tr. at 1254:7–25 (Hill), 1259:2–12 (Hill), 1233:14–20 (Hill). Thus, the $250,000 cutoff is merely useful; it is not intended to be a rigid bright line, but rather is helpful "[f]or analytical purposes" to facilitate the assessment of anti-competitive effects. *FTC v. Staples, Inc.*, 190 F. Supp. 3d 100, 118 & n.10 (D.D.C. 2016) ("*Staples II*") ("[T]here is no 'magic place that's the right place' to draw the line." (quoting government expert's testimony)). Accordingly, the Court rejects this argument against the government's defined market.

The Court is unswayed by the defendants' tactic of enumerating other markets or submarkets in which competition would not be harmed by the merger. In addition to proposing submarkets at the $50,000- and $1 million- advance levels, the defendants also declare that the government could not prove anticompetitive effects from the merger in the broad market of publishing rights for all U.S. trade books, or in the downstream market for retail book sales. *See* Defs. PFOF ¶¶ 29–31. Those protestations are beside the point because the Clayton Act prohibits mergers that may substantially lessen competition "in *any* line of commerce or in *any* activity affecting commerce." 15 U.S.C. § 18 (emphasis added). Thus, even if alternative submarkets exist at other advance levels, or if there are broader markets that might be analyzed, the viability of such additional markets does not render the one identified by the government unusable. *See United States v. Cont'l Can Co.*, 378 U.S. 441, 456–58 (1964) (validating a relevant product market of glass and metal containers, even though "there may be a broader product market made up of metal, glass and other competing containers"); *United States v. Aluminum Co. of Am.,* 377 U.S. 271, 275 (1964) (explaining that even though insulated aluminum conductor and insulated copper conductor could both be in "a single product market," that "does not preclude their division for purposes of [Section] 7 into separate submarkets"); *see also Brown Shoe*, 370 U.S. at 325; *Anthem*, 236 F. Supp. 3d at 201–02 .

Ample precedent supports the government's use of a numerical cutoff to identify a submarket. It is common for courts to use seemingly arbitrary criteria to home in on a segment of a broader industry. *See Wilhelmsen*, 341 F. Supp. 3d at 51 (market of customers with fleets of 10 or more global maritime vessels); *Anthem*, 236 F. Supp. 3d at 195 (market of companies with 5,000 or more employees); *Staples II*, 190 F. Supp. 3d at 118 (market of customers who spend $500,000 or more annually on office supplies). In *Wilhelmsen*, Judge Chutkan approved a relevant market "defined around the FTC's preferred set of targeted customers" — "Global Fleets." 341 F. Supp. 3d at 48, 58. The government characterized "Global Fleets" as "fleets of 10 or more globally trading vessels." *Id.* at 51. Although the defendants argued "that the Global Fleets construct is premised on arbitrary thresholds," the court found that such fleets "are a distinct group with distinct needs," even though the "choice of ten globally trading vessels was arbitrary in the sense that the number ten is not compelled by a specific market reality." *Id.* at 51–54. Judge Chutkan explained that the government's expert "chose ten as a starting point for developing a series of statistical estimates, the non-statistical implications of which support the appropriateness of regarding Global Fleets as a distinct customer group." *Id.* at 55. In other words, the cutoff of ten ships to define "Global Fleets" was an appropriate analytical tool, just as the choice of a $250,000-minimum advance level to define "anticipated top-selling books" is appropriate for analytical purposes. At bottom, such "construct[s]" provide a "useful way to discuss and predict economic conditions" because their "key aspects correspond to elements of the existing marketplace that would make it possible to profitably target a subset of customers [or sellers] for price increases [or decreases] post-merger." *Id.* at 52 (quoting *Sysco*, 113 F. Supp. 3d at 38).

The government's focus on anticipated top-selling books also is consistent with cases in which courts have recognized the "high end" of other broad markets as distinct submarkets for antitrust purposes. *See, e.g.*, *Int'l Boxing Club of N.Y., Inc. v. United States*, 358 U.S. 242, 251 (1959) (affirming district court's conclusion "that nonchampionship fights are not 'reasonably interchangeable for the same purpose' as championship contests" and explaining that defining the relevant market "involves distinction in degree as well as distinctions in kind"); *Whole Foods*, 548 F.3d at 1032 (recognizing relevant submarket of "premium, natural, and organic supermarkets" that "generally target affluent and well educated customers"); *O'Bannon v. Nat'l Collegiate Athletic Ass'n*, 7 F. Supp. 3d 955, 986–88 (N.D. Cal. 2014) (recognizing relevant submarket of "elite football and basketball recruits"), *rev'd in part on other grounds*, 802 F.3d 1049 (9th Cir. 2015). Thus, the relevant market defined here falls comfortably within the parameters set by numerous applicable precedents.

The defendants nevertheless fault the government for defining its submarket by "price alone," contending that any correlation between advance level and expected sales shows only that books "are valued along a *continuum*." *See* Defs. PCOL ¶¶ 12, 24–25 (emphasis in original). They argue that the existence of "a spectrum of price or value" is insufficient to establish a submarket and, accordingly, that the government's market is not appropriately defined. *Id.*[18] Once again, such arguments overlook the purpose of the $250,000 threshold as an

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18 In support, the defendants primarily rely on *In re Super Premium Ice Cream Distribution Antitrust Litig.*, 691 F. Supp. 1262 (N.D. Cal. 1988), *aff'd sub nom. Haagen-Dazs Co. v. Double Rainbow Gourmet Ice Creams, Inc.*, 895 F.2d 1417 (9th Cir. 1990), and *United States v. Oracle Corp.*, 331 F. Supp. 2d 1098 (N.D. Cal. 2004). The Court finds both *In re Super Premium Ice Cream* and *Oracle* inapposite. Neither case concerns a market of targeted sellers or buyers, as relevant to this case. Further, in *In re Super Premium Ice Cream*, the evidence showed that consumers who bought higher-priced "super premium" ice cream could and would buy lower-quality ice cream as a substitute. *See* 691 F. Supp. at 1268. Here, authors of anticipated top-selling books have no alternative to selling their books to a publisher because, as addressed in Section I.C, self-publishing is not a realistic alternative. Because they have no reasonable substitute, authors can be targeted for and impacted by a decrease in prices, in a manner that ice-cream customers could not have been targeted by a price increase. As for *Oracle*, there, the government

analytical tool that facilitates the examination of market shares and anticompetitive effects. The threshold number need not represent an exact point at which the market begins to distinguish a product. *See Wilhelmsen*, 341 F. Supp. 3d at 54–55; *Anthem, Inc.*, 236 F. Supp. 3d at 200 (accepting a 5,000-employee threshold to define "national accounts" even though the "threshold may exclude some products that would meet the needs of smaller employers"); *Staples II*, 190 F. Supp. 3d at 118 & n.10 ("[T]here is no 'magic place that's the right place' to draw the line." (quoting government expert's testimony)). Rather, a threshold will necessarily represent a "starting point" for "statistical estimates, the non-statistical implications of which support the appropriateness of regarding" anticipated top-selling authors as a "distinct [seller] group" that buyers can target. *Wilhelmsen*, 341 F. Supp. 3d at 55.

ii. The Remaining *Brown Shoe* Factors

Aside from distinct pricing, the government argues that the remaining *Brown Shoe* factors demonstrate that there is a relevant submarket for the publishing rights to anticipated top-selling books. *See* Govt. PFOF-PCOL ¶¶ 87–114, 117–121. The government contends that such books have "peculiar characteristics and uses," in that they require stronger marketing, publicity, and sales support, which allow them to reach a broader audience of readers. *Id.* ¶¶ 87 (quoting *Brown Shoe*, 370 U.S. at 325), 93–95. In addition, authors of anticipated top-selling books are "distinct sellers," in that they (1) care more about their publishers' reputation and services, which ensure wider distribution of their books; (2) may receive more favorable contract terms than other authors; and (3) face different competitive conditions, as demonstrated by the dominant

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attempted to define a market of "high function" software and tried to use a minimum sale price of $500,000 to identify such software. *See* 331 F. Supp. 2d at 1158. Yet there were several flaws in the data analyzed and presented by the government's expert. *See id.* at 1158–59. Nor did the government offer any other qualitative or quantitative evidence to define the market. *See id.* Here, Dr. Hill's data suffers from no similar flaws and the government has marshalled evidence beyond the advance price to show practical indicia of a submarket for the publishing rights to anticipated top-selling books.

market share of the Big Five (91%) in publishing anticipated top sellers. *See id.* ¶¶ 66, 93–114, 117–119. For all those reasons, the government argues, anticipated top-selling books are in a different category from books that are expected to sell relatively few copies, and publishers can target their authors for price decreases.

The defendants, however, insist that all books are in the same market. They argue that books at all advance levels go through an identical editing, marketing, and distribution process; that there is no difference in the personnel who handle such books; that the contracts for all books are negotiated in the same way; and that any special terms in the contracts for some books simply result from an agent's leverage. *See* Defs. PFOF ¶¶ 47–67; Defs. PCOL ¶ 21. Further, they contend that publishers cannot predict which books will be top sellers. *See* Defs. PFOF ¶¶ 78 ("[P]ublishers generally have no objective criteria for reaching in advance a consensus on whether a book is likely to be a top selling book."), 79 (arguing that publishers "cannot easily predict top sellers," other than books by celebrity, franchise, or prize-winning authors), 75 (asserting that every book is individual and author atypical) (citing Trial Tr. at 1068:12–13 (Weisberg), 1952:20–25 (Duhigg)); Defs. PCOL ¶ 21.

The Court has no trouble recognizing that anticipated top-selling books are distinct from the vast majority of books that do not carry the same expectations for success. Obviously, the entire publishing industry is dedicated to selling books; and all editors and publishers naturally are very focused on discovering and acquiring the books that they believe will drive sales. Evidence strongly supports the conclusion that, from the perspective of editors and publishers, not all books are created equal. Beyond advances, contracts for books that are expected to sell well are more likely to include favorable terms like higher royalty rates, higher levels of marketing support, "glam" packages (*e.g.*, for hair, makeup, and wardrobe services), and airfare for authors.[19] *See* Trial Tr. at 988:2–8 (Dohle) ("Very rarely, if ever, will I negotiate the other royalty rates, but if it were to happen, it would be at that very, very top tier advance level."), 1132:17–23 (Weisberg) ("top end" authors can negotiate terms such as payment schedules, bonuses, and glam budgets), 1819:9–1820:2 (Walsh) (customization of contract terms is generally correlated with higher advances), 1828:8–18 (Walsh) (higher marketing commitments are expected for higher advance books); DX 21 at 5 (agent demanding "a publisher ready to commit incredible energy and resources"). Publishers print more of the books they think will do well; circulate more advance copies of such books to reviewers or influencers to create excitement; push for interviews with more media outlets; and schedule book-tour appearances in more locations.[20] *See* Trial Tr. at 1373:12–1374:3 (Murray); PX 986. Anticipated top-selling books also get more attention from marketing and sales teams.[21] For example, Dr. Hill determined that S&S and PRH spend, on average, under $10,000 on marketing for books with advances under $250,000, and between $40,000 and $90,000 on marketing for books with advances over $250,000:

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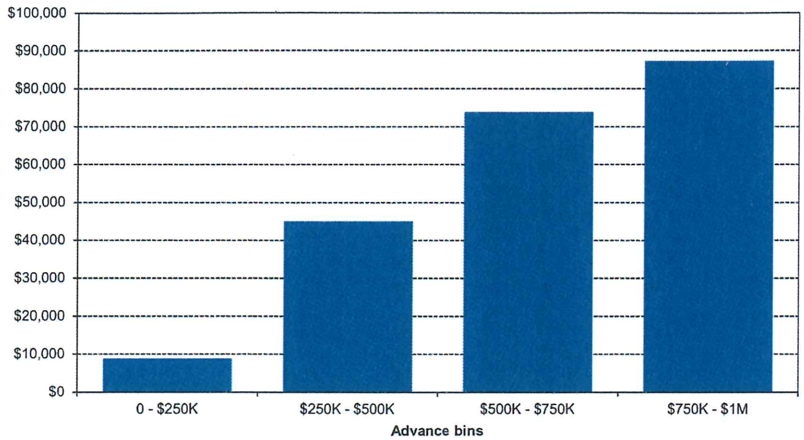
19 For example, Crown, a former publishing division of PRH that later merged with the Random House division, produced guidelines for marketing support based on expected sales and advance levels. *See* PX 986; Trial Tr. at 2275:19–2278:1 (McIntosh). Under those guidelines, books with expected sales of more than 25,000 units or advances of more than $150,000 were to receive a dedicated publicist, book tours with stops in 5 to 15 markets, extensive national media engagement, prominent placement on PRH and partner websites, and targeted social media pushes. *See* PX 986 at 2–4. By contrast, books with advances and sales under those thresholds were to have only a contact in the publicity department, smaller book tours (if any), and limited media engagement. *See id.* at 5–9.

20 Some of the defendants' witnesses testified that all books are anticipated to sell well. *See* Trial Tr. at 576:17–24 ("[A] good editor worries about every book that he or she acquires, making every book profitable."), 1810:17–1812:4 (Walsh) ("I would say I always anticipate that what I am working on is going to be a best seller."). That assertion is not credible. Although an agent, author, or publisher may "hope" every book will be a hit, that is not the same as anticipating or expecting that a book will do well. *See id.* at 1813:4–6 (The Court: "You don't expect every single book you work on to be a best seller or top seller?" Walsh: "Right. I hope."); *see also id.* at 328:2–10 (King) (explaining that he chose a smaller publisher for a book that "wasn't a crafted best seller"), 593:21–594:8 (Karp) (recognizing that some books are "midlist" books that publishers are "hoping," but not anticipating, will be hits).

21 *See* Trial Tr. at 258:14–21 (Pande) ("I would say that there's a pretty clear relationship between the level of the advance and the amount of resources that the publisher invests in the marketing and publicity of the book."), 490:13–492:4 (Karp) ("[T]he big obvious books that we spent a lot of money for, they definitely have to be marketed and publicized aggressively."), 1373:1–11 (Murray), 2001:12–2002:4 (Kim); PX 989 (Putnam post-publication P&L sheet) (showing general correlation between advance level and marketing spending).



See PX 972.

The fact that the Big Five publish 91 percent of anticipated top sellers also supports a finding that the authors of such books have unique needs and preferences. *See* PX 963. Although smaller publishers can sometimes put out an anticipated top-selling book, it is the Big Five who have the back lists and the marketing, publicity, and sales advantages necessary to consistently provide the high advances and unique services that top-selling authors need. *See supra* Section I.C (discussing Big Five's publishing advantages). It is precisely those specialized needs that make the authors of anticipated top-selling books vulnerable to targeting for price reductions. Publishers of anticipated top-selling books know that such authors are not able to find adequate substitutes for publishing their books because of their unique needs and preferences. *See id.* Those publishers therefore can target authors of anticipated top-selling books for a decrease in advances (prices) because it is not as likely that such a price decrease will cause the publishers to lose a book. *See Wilhelmsen*, 341 F. Supp. 3d at 56–57 (finding targeted buyer market where market was characterized by individual negotiations and customers had unique needs and preferences); *Staples II*, 190 F. Supp. 3d at 127 (finding targeted buyer market where industry recognized customers as a distinct group that needed specific prices and services); *see also* Merger Guidelines § 4.1.4.

Although the defendants proclaim that no one in the industry uses the term "anticipated top seller," Defs. PFOF ¶¶ 87–88, that does not mean that such books do not exist. *See Wilhelmsen*, 341 F. Supp. 3d at 51–52 (rejecting defendant's argument "that the definition of Global Fleets does not accord with commercial reality, given that [defendants do not] use the FTC's definition of that term . . . ."); *see also Le v. Zuffa, LLC*, 216 F. Supp. 3d 1154, 1159, 1165–66 (D. Nev. 2016) (denying motion to dismiss that was based in part on defendant's argument that "Elite Professional MMA fighters" is not a term used in the industry). In fact, market participants have other names for expected top sellers, such as "lead titles" or "priority titles."[22] Regardless of nomenclature, clear evidence demonstrates that the practice of identifying and giving special support to the books that will drive sales is common. The government's defined market thus reflects "commercial realities" in the publishing industry. *United States v. Grinnell Corp.*, 384 U.S. 563, 572 (1966).

The defendants' position that individual publishers are unable to anticipate which books will be top sellers is unsupportable. That contention is contradicted by the universal industry practice of making a sales estimate for every single book before offering an advance, and credible testimony that there is often consensus among editors and publishers about which books will be popular with readers. *See supra* Section I.C; Trial Tr. at 2108:14–24 (Wylie) ("But I think there are recognizable qualities in — in books that people who have been in the business

[22] "Lead titles" or "priority titles" are expected to sell well and receive more significant marketing, publicity, and sales support. *See* PX 986 (Crown internal guidance identifying "lead titles" as books with a sales goal of 75,000 units or advances of $500,000, and advising increased marketing, sales, and publicity support for those titles); PX 2005 at 24–27; Trial Tr. at 1071:4–1072:15 (Weisberg) (defining lead title as "top of the list"), 1988:19–25 (Kim) ("So every season, we have two or three titles that we really designate as lead titles, titles that we feel we really want the sales team to really love and read, books that we feel we want to put a lot of attention on and marketing support for."). They also generally receive high advances. *See* Trial Tr. 1071:4–1072:15 (Weisberg) ("[I]f we spend a lot of money on a book and it's a book that everybody loves, it becomes a lead title."), 2268:9–2269:22 (McIntosh) ("[I]f we had a really high sales expectation at time of acquisition and then by the time we're ready to publish the book, we still have a sales — a high sales expectation, then it would seem logical to me that – that there could be a high advance attached to that.").

for a long time would easily recognize."). The defendants' high share of the book-acquisition market and their substantial profit margins strongly indicate that they are successfully choosing books that people want to read. *See* PX 994; Trial Tr. at 781:3–5 (Dohle), 1492:2–3 (Hill). To be sure, editors often offer a range of advances for any given book, and the defendants correctly note that there are many examples of books that were unexpected best sellers, such as Stephen King's *Carrie*, or Marie Kondo's *The Life-Changing Magic of Tidying Up*. *See* Defs. PFOF ¶¶ 79, 81. But it is commonplace for multiple editors to gravitate to the same book, as evidenced by the routine occurrence of competitive auctions; and the defendants do not dispute that there is a general correlation between author advances and book sales, *see* Trial Tr. at 749:4–22 (Dohle); PX 151 at 11. That is strong evidence that the book-acquisition process is not random. Indeed, whenever a publisher submits a bid of $250,000 or more for a book, that publisher has determined that the book is likely to be a top seller and knows that the competitors for the book are likely to be limited to the Big Five. *See* Trial Tr. at 153:10–13 (Pietsch) (other Big Five publishers are Hachette's main competitors for books with advances over $250,000); PX 530 at 2 (Big Five publishers are S&S's "biggest competitors . . . since they are the most likely to come up with high advance payments required . . . ."). These practical indicia in the publishing industry strongly support the existence of the identified relevant market.

One high-end submarket case that the Court finds highly relevant is *Syufy Enterprises v. American Multicinema, Inc.* In *Syufy*, the Ninth Circuit upheld a relevant submarket "for [the] exhibition of industry anticipated top-grossing motion pictures in the San Jose area." 793 F.2d at 994. Anticipated blockbusters, the court explained, "are identifiable . . . on the basis of such criteria as national advertising support, longer playtimes, guaranteed rentals, famous stars, directors and producers, booking in first class theatres, and lucrative terms offered for the pictures by exhibitors." *Id.* at 994–95. Those indicia are analogous to some of the features of anticipated top-selling books, such as: more substantial marketing, publicity, and sales support; authors who are prominent or have a track record of success; and higher advances. Moreover, the appellant in *Syufy* challenged the existence of the market for "anticipated top-grossing motion pictures" by making arguments similar to those pressed by the defendants here, insisting that the market was "ex post facto and ad hoc," that "all first run films are in substantial competition with each other," and that such films "possess no special characteristics that differentiate them from less successful films from an ex ante perspective." *Id.* at 994. This Court joins the Ninth Circuit in rejecting such arguments. As discussed, distinctive characteristics set anticipated top-selling books apart from the rest of the pack.

In sum, this case demonstrates that "[w]hatever the market urged by the [government], the other party can usually contend plausibly that something relevant was left out, that too much was included, or that dividing lines between inclusion and exclusion were arbitrary." *FTC v. Tronox Ltd.*, 332 F. Supp. 3d 187, 202 (D.D.C. 2018) (quoting 2B Phillip E. Areeda & Herbert Hovenkamp, *Antitrust Law* ¶ 530d (4th ed. 2014) [hereinafter Areeda, *Antitrust Law*]). Yet "[t]he Supreme Court has wisely recognized there is 'some artificiality' in any boundaries, but that 'such fuzziness' is inherent in bounding any market." *Id.* (quoting Areeda, *Antitrust Law* ¶ 530d); *Anthem*, 236 F. Supp. 3d at 193 ("The 'market,' as most concepts in law or economics, cannot be measured by metes and bounds." (quoting *Times-Picayune Publ'g Co. v. United States*, 345 U.S. 594, 611 (1953)). Market definition is more art than science, *see RAG-Stiftung*, 436 F. Supp. 3d at 312–13, and it is critical to remember that the goal of the exercise is to enable and facilitate the examination of competitive effects. *See Brown Shoe*, 370 U.S. at 320–22;

Cont'l Can , 378 U.S. at 452–55. In this Court's view, the government has easily cleared the bar.[23]

2. Supply Substitution

The traditional way to define a relevant market in the monopsony context would be to examine "the commonality and interchangeability of the buyers" of a certain good. *Todd v. Exxon Corp.*, 275 F.3d 191, 202 (2d Cir. 2001). Indeed, "'the outer boundaries of a product market are determined by the reasonable interchangeability of use or the cross-elasticity of [supply] between the product['s buyers, in the case of monopsony,] and the substitutes for [such buyers].' Accordingly, the touchstone is [supply] substitution . . . ." *See Wilhelmsen*, 341 F. Supp. 3d at 45 (quoting *Brown Shoe*, 370 U.S. at 325).

To test the proposed market boundaries, courts commonly turn to the "hypothetical [monopsonist] test." *Sysco*, 113 F. Supp. 3d at 38. The hypothetical monopsonist test "ensures that markets are not defined too narrowly," on the theory that if the test identifies substitute buyers for the product in question, such buyers should be included in the market. *See* Merger Guidelines § 4.1.1 (describing hypothetical monopolist test). The hypothetical monopsonist test assumes that there is only one buyer in the proposed market and asks whether that hypothetical buyer, freed from price regulation, "could profitably target a subset of [sellers] for price [decreases]." *Sysco*, 113 F. Supp. 3d at 38 (quoting Merger Guidelines § 4.1.4). If such a hypothetical monopsonist could profitably impose what economists call a "small but significant

23 To define a market around a targeted seller, sellers must not only be identifiable by buyers for differential pricing but also must be unable to engage in arbitrage or opportunistic re-selling. *See Staples II*, 190 F. Supp. 3d at 117–118; Merger Guidelines § 3. The foregoing discussion establishes that anticipated top-selling books are subject to differential pricing. Authors of those books also cannot realistically engage in arbitrage by selling their books to a third party who would then sell the books to publishers for a better price. *See* Trial Tr. at 1230:7–23 (Hill). As Dr. Hill testified, publishers would still need to read the book or proposal and value it in the same manner as if the book were submitted directly by the author. *See id.*

and non-transitory [decrease] in price" of at least five percent in the proposed market, that indicates the existence of a relevant market. *Id.* at 33–34 (quoting Merger Guidelines § 4.1.4).

Here, the government includes all publishing firms in the market to acquire the publishing rights for anticipated top-selling books. *See* Govt. PFOF-PCOL ¶ 79. Applying Judge Mehta's explanation of the test to the instant facts, we arrive at the following analysis:

> If enough [authors] are able to substitute away from [selling their books to] the hypothetical [publisher monopsonist] to another [way of distributing their books] and thereby make a [decrease in advances] unprofitable, then the relevant market cannot include only the [publisher monopsonist] and must also include the substitute [method of distribution]. On the other hand, if the hypothetical [publisher monopsonist] could profitably [lower advances to authors] by a small amount, even with the loss of some [authors], then economists consider the [publishers] to constitute the relevant market.

See Sysco, 113 F. Supp. 3d at 33; *see also* Merger Guidelines § 12 ("In defining relevant markets [in buy-side cases], the Agencies focus on the alternatives available to sellers in the face of a decrease in the price paid for by a hypothetical monopsonist. Market power on the buying side of the market is not a significant concern if suppliers have numerous attractive outlets for their goods or services.").

The government's expert, Dr. Hill, estimated what "actual diversions" would be for the defined market, *i.e.*, the percentage of authors who would switch to self-publishing in the face of a "small but significant and non-transitory [de]crease" in advances paid for anticipated top-selling books. He found that even if some small number of authors switched to self-publishing, it would be profitable for publishers to decrease advances — that is, the defection of authors in response to the lowered advances would be far less than what would be necessary to make the decrease unprofitable. *See* Trial Tr. at 1245:14–1246:9 (Hill).

The defendants do not dispute that the relevant market of "publishing rights to anticipated top-selling books" passes the hypothetical monopsonist test. *See* Trial Tr. at 2897:18–2898:18 (Snyder). They instead argue that the test is inapposite here because it does not address the alleged arbitrariness of the $250,000 threshold for bounding the market, *see id.*; Defs. PFOF ¶ 44; indeed, submarkets at all but the lowest advance thresholds should pass the hypothetical monopsonist test because self-publishing generally is a poor substitute for the services of an established publisher. *See* Trial Tr. at 2898:8–18 (Snyder) ("[S]elf-publishing is not a relevant constraint."); *supra* Section I.C (further detailing inadequacy of self-publishing). The incongruence of the hypothetical monopsonist test here is not surprising because it examines substitutes for the *buyers* in the market, while the government's proposed market is one of "targeted *sellers*": In this case, the test and the market-definition dispute are focusing on different sides of the market.[24] Although the Court agrees that the hypothetical monopsonist test sheds no light on the contested issues in this case, it is sufficient to note for present purposes that the test is a standard analytical tool in merger cases; and that it concededly supports the government's definition of the relevant market. Defendant's other objections to the relevant market have been addressed *supra.*

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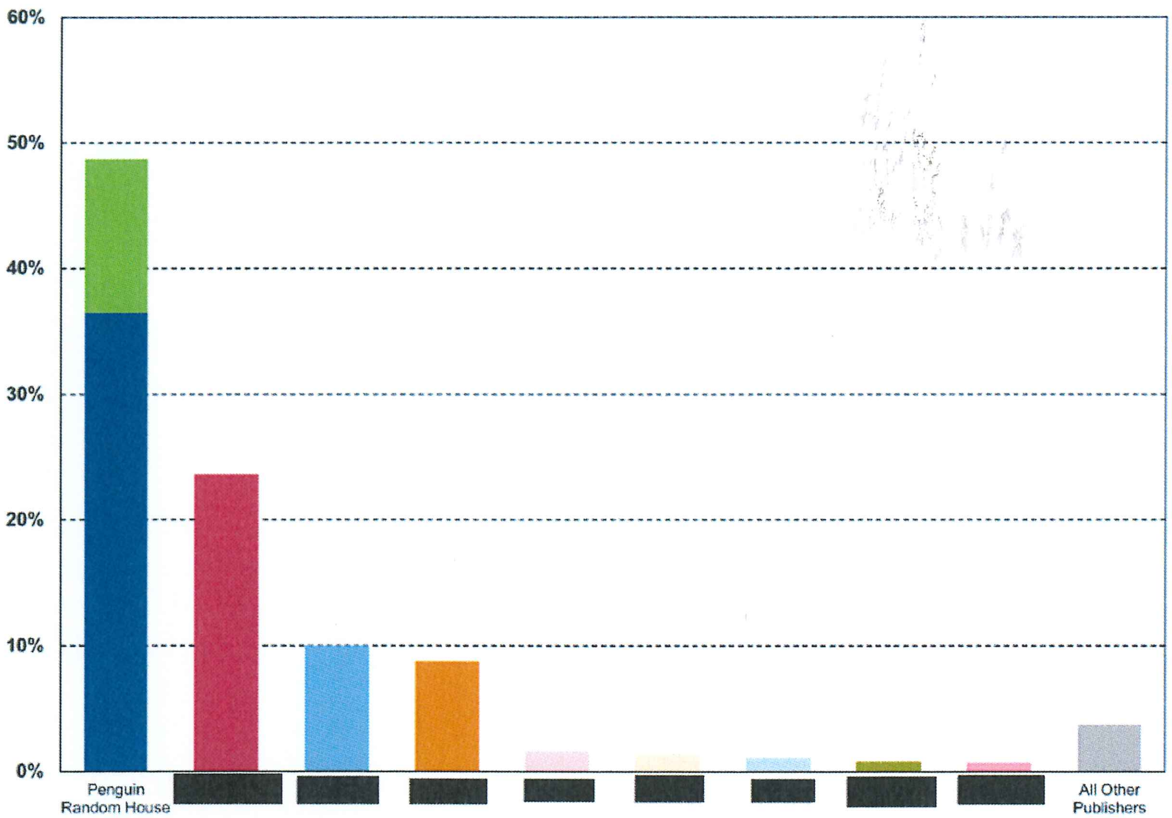
[24] For this reason, the defendants' argument that the government has not defined the "narrowest market," as required by some case law, lacks merit. *See* Defs. PCOL ¶¶ 35–41 (citing Merger Guidelines § 4.1.1; *RAG-Stiftung*, 436 F. Supp. 3d at 292; *Sysco*, 113 F. Supp. 3d at 26–27; *United States v. H & R Block, Inc.*, 833 F. Supp. 2d 36, 58–60 (D.D.C. 2011); *FTC v. Arch Coal, Inc.*, 329 F. Supp. 2d 109, 120 (D.D.C. 2004)). The cases relied upon by the defendants focus on defining the market by reference to demand substitution and applying the hypothetical monopolist test, while the instant case concerns a market defined by targeted sellers as articulated by the Merger Guidelines. *See* Merger Guidelines § 4.1.4 ("If prices are negotiated individually with customers, the hypothetical monopolist test may suggest relevant markets that are as narrow as individual customers . . . . Nonetheless, the Agencies often define markets for groups of targeted customers, i.e., by type of customer, rather than by individual customer. By so doing, the Agencies are able to rely on aggregated market shares that can be more helpful in predicting the competitive effects of the merger.").

B. Prima Facie Case

1. Market Concentration

Once the relevant market has been established, the next step is straightforward: "[T]he government must show that the merger would produce 'a firm controlling an undue percentage share of the relevant market, and would result in a significant increase in the concentration of firms in that market.'" *See Heinz*, 246 F.3d at 715 (quoting *Phila. Nat'l Bank*, 374 U.S. at 363 (alterations omitted)). Market concentration is fundamental to merger analysis. "That competition is likely to be greatest when there are many sellers, none of which has any significant market share, is common ground among most economists, and was undoubtedly a premise of congressional reasoning about the antimerger statute." *Phila. Nat'l Bank*, 374 U.S. at 363 (cleaned up); *see also Heinz*, 246 F.3d at 715 ("[W]here rivals are few, firms will be able to coordinate their behavior, either by overt collusion or implicit understanding, in order to restrict output and achieve profits above competitive levels." (cleaned up)). Thus, demonstrating post-merger "'undue'" market concentration "establishes a 'presumption' that the merger will substantially lessen competition." *Heinz*, 246 F.3d at 715 (first quoting *Phila. Nat'l Bank*, 374 U.S. at 363; and then quoting *Baker Hughes*, 908 F.2d at 982). In *Philadelphia National Bank*, the Supreme Court held that a significant change in concentration that results in a combined market share of at least 30 percent is sufficient to establish the legal presumption that a merger violates Section 7. 374 U.S. at 331, 364 (merger to a 36% market share with the top four banks controlling a combined 78%); *see also Hosp. Corp.*, 807 F.2d at 1384 (determining that FTC's finding that transaction was unlawful was supported by substantial evidence where defendant's market share was raised from 14% to 26% and the market share of the four largest firms from 79% to 91%); *cf. Heinz*, 246 F.3d at 711, 715–17 (holding FTC established presumption through statistics about the change in market concentration where defendants would have a combined market share of 32.8%).

The government's expert, Dr. Hill, calculated market shares based on a comprehensive set of data from more than sixty publishers. *See* Trial Tr. at 1251:12–1252:3 (Hill). According to his calculations, the merging firms account for nearly half (49 percent) of the publishing market for anticipated top-selling books, and the newly constituted "Big Four" that would emerge after the deal would control approximately 91 percent. Trial Tr. at 1254:3–6 (Hill). Government's Exhibit 959 graphically depicts the post-merger market shares:



The second-largest market participant post-merger would be [redacted] with 24 percent of the market, while [redacted] and [redacted] would have 10 percent and 9 percent, respectively. *See* PX 959. The non-Big Four would have the remaining 9 percent. *See id.* Dr. Hill also calculated market shares using different advance thresholds to bound the relevant market and found similar results. *See* PX 960. The post-merger market shares undoubtedly portray a highly concentrated market dominated by four main players, with the leading, merged company holding an "undue percentage share." The 49-percent share that the post-merger PRH would hold is far above the levels deemed too high in other cases. *See, e.g.*, *Phila. Nat'l Bank*, 374 U.S. at 364 (36%); *cf. Heinz*, 246 F.3d at 711, 715–17 (32.8%). The substantial market share of the proposed combined entity justifies a strong presumption of anticompetitive effects. *See Baker Hughes*, 908 F.2d at 991 ("The more compelling the prima facie case, the more evidence the defendant must present to rebut it successfully."). Moreover, the high concentration must be considered in the context of an undeniable trend in consolidation in the publishing industry. *See United States v. Pabst Brewing Co.*, 384 U.S. 546, 552–53 (1966) ("[A] trend toward concentration in an industry, whatever its causes, is a highly relevant factor in deciding how substantial the anti-competitive effect of a merger may be.").

The post-merger market also would be unduly concentrated under the Herfindahl-Hirschman Index ("HHI"), a measure commonly used to evaluate market concentration. *See RAG-Stiftung*, 436 F. Supp. 3d at 310 n.26 (explaining calculation of HHI). The HHI is a formula "used to estimate the competitiveness of the market on the basis of the number and size of the firms." Areeda, *Antitrust Law* ¶ 930a. It provides a "short cut to establish a presumption of anticompetitive effect through statistics about the change in market concentration." *AT&T, Inc.*, 916 F.3d at 1032. "The HHI estimates market concentration by summing the squares of the market share of every firm in the market. . . . When one assesses the competitive impact of a merger, the important numbers are (1) the *post*-merger HHI; and (2) the amount the merger increases the HHI." Areeda, *Antitrust Law* ¶ 930a (emphasis in original). An increase in the index above certain levels "establish[es] the [government's] prima facie case that a merger is anti-competitive." *Heinz*, 246 F.3d at 716. Under the Merger Guidelines, if an acquisition (1) increases the HHI of a relevant market by more than 200 points and (2) results in a post-acquisition HHI exceeding 2500, it is presumptively anticompetitive. *See* Merger Guidelines § 5.3; *see also Staples II*, 190 F. Supp. 3d at 128; *H & R Block*, 833 F. Supp. 2d at 71–72 (enjoining transaction that would have given the combined firm only a 28.4 percent market share because the transaction would have resulted in an increase in the HHI of more than 200 and a post-acquisition HHI that would have exceeded 2500). Here, the post-merger HHI would be 3,111, with an increase of 891, well above the thresholds required to trigger the presumption under the Guidelines. Trial Tr. at 1256:24–1258:11 (Hill), 1259:4–12 (Hill).[25]

Based on the market-share analysis and the HHI analysis, the government has met its burden to establish that the proposed merger between PRH and S&S would produce "a firm controlling an undue percentage share of the relevant market, and [would] result[] in a significant increase in the concentration of firms in that market." *Phila. Nat'l Bank*, 374 U.S. at 363. That showing alone is sufficient to establish a prima facie case. *Heinz*, 246 F.3d at 716 ("Sufficiently large HHI figures establish the FTC's prima facie case that a merger is anti-competitive." (citing *Baker Hughes*, 908 F.2d at 982–83 & n.3)). Notably, the defendants do not question the accuracy of Dr. Hill's market-share calculations, nor his application of the HHI.

The government further notes that the market shares reflect the actual competitive dynamics in the market. *See* Govt. PFOF-PCOL ¶¶ 135–97. Dr. Hill compiled several different data sets to evaluate how frequently the merging parties compete against each other and against

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25 Moreover, post-merger HHIs (and the post-merger increase) also are above the presumption thresholds if the relevant market is defined using a variety of other advance cutoffs (*e.g.*, $150,000, $350,000, $500,000, or $1 million). Trial Tr. at 1254:7–25 (Hill); *see also* PX 960.

other publishers. As discussed in more detail below, *see infra,* Section II.B.2.i, the data tracks the instances where the merging parties lost books to one another, and where they were "runners-up" to each other in book acquisitions. Dr. Hill's analysis of the data reveals that, as market shares would predict, the Big Five in fact dominate book acquisitions in the relevant market. Consistent with their market shares, when S&S loses a book, it most often loses to PRH; and when S&S wins a book, its most likely runner-up is PRH. *See* Trial Tr. at 1282:15–24 (Hill) (indicating that for books acquired by S&S, PRH was the runner-up approximately 60% of the time); PX 970 (showing diversion ratios); *see also* Trial Tr. at 2927:17–2928:4 (Snyder) (PRH is also the most frequent runner up to S&S according to Professor Snyder's data set). Moreover, an independent deal tracker maintained by Hachette for acquisitions above $500,000 also depicts results consistent with market shares: Roughly 90 to 95 percent of Hachette's losses in that advance range were to other Big Five publishers. *See* PX 790 (tracking Hachette's losses to these publishers); Trial Tr. at 191:16–194:24 (Pietsch).

Also significant is the stability of the market shares held by the primary market participants over time. Based on Dr. Hill's comprehensive data set, which included information from approximately 1,200 book contracts per year, the market shares of the Big Five in acquiring anticipated top-selling books has remained stable for the past three years. *See* PX 967. Furthermore, the Big Five's market shares versus the non-Big Five have also been consistent: The data demonstrate that the aggregate market share of non-Big Five publishers has been "essentially flat." Trial Tr. at 1482:15–25. This stability suggests that more weight should be assigned to market shares, *see* Merger Guidelines § 5.3 ("The Agencies give more weight to market concentration when market shares have been stable over time . . . ."), and thus reinforces the presumption of anticompetitive effects based on market concentration.

2. Other Evidence

The government does not rely solely on the high degree of market concentration that would result from the merger, and the attendant presumption of anti-competitive harm; instead, the government also "bolster[s] its prima facie case by offering additional evidence." *Wilhelmsen*, 341 F. Supp. 3d at 59. The government presents evidence that (1) the merger will cause anticompetitive effects from the elimination of competition between PRH and S&S, and (2) the higher concentration in the post-merger market will increase the risk of coordinated anticompetitive conduct by the largest publishers. *See* Govt. PFOF-PCOL ¶¶ 135–97.

i. Unilateral Effects

Mergers necessarily eliminate the competition between the merging companies. *See Heinz*, 246 F.3d at 717. The government contends that PRH and S&S currently compete "fiercely" to publish anticipated top-selling books, and that eliminating direct competition between them is likely to harm authors. Govt. PFOF-PCOL ¶ 244. Indeed, "[c]ourts have recognized that a merger that eliminates head-to-head competition between close competitors can result in a substantial lessening of competition." *Sysco*, 113 F. Supp. 3d at 61; *see also Wilhelmsen*, 341 F. Supp. 3d at 59. "Unilateral effects" are those that result directly from the elimination of competition between the merging parties. *Anthem*, 236 F. Supp. 3d at 216. As explained by the Merger Guidelines, "[a] merger can enhance market power simply by eliminating competition between the merging parties. This effect can arise even if the merger causes no changes in the way other firms behave." Merger Guidelines § 1. Unilateral effects may be especially acute in a "highly concentrated market." *Staples I*, 970 F. Supp. at 1083.

a. Head-to-Head Competition

The analysis of unilateral effects focuses on how closely the merging firms currently compete, in order to extrapolate the effects of eliminating that competition. *See* Merger Guidelines § 6.2. Evidence in the record demonstrates that PRH and S&S are close competitors for anticipated top-selling books. Specifically, PRH is the publisher against which S&S competes the most frequently and to which S&S loses the most. *See* Trial Tr. at 595:23–25 (Karp) (agreeing that PRH is the "publisher [S&S] bid[s] against the most"), 1280:17–1281:17 (Hill) (reviewing win/loss data showing that S&S loses to PRH about 60% of the time). Meanwhile, S&S is a significant competitor to PRH, *see id.* at 2360:20–23 (McIntosh), 1275:25–1276:6 (Hill), and makes a particularly strong showing in biographies, memoirs, political nonfiction, and books about current events, *see id.*. at 454:23–455:3 (Karp), 455:8–11 (Karp); PX 326 at 2 ("S&S has political bestseller chops like no other right now.").

The government's expert, Dr. Hill, conducted a variety of economic analyses that assess how closely PRH and S&S compete. Dr. Hill used four different methods to calculate "diversion ratios," which measure head-to head competition between the merging parties by asking the following question: If one merging party lowered advance levels, what percentage of its authors would "divert" their business to the other merging party, as opposed to diverting to other firms in the industry? A higher diversion ratio indicates that the merging parties are close competitors and that the merger is more likely to lead to harm. *See* Trial Tr. at 1274:2–12 (Hill); *see also* Merger Guidelines § 6.1.

Dr. Hill calculated diversion ratios based on: (1) diversion proportional to market shares, which is the largest data set; (2) win/loss data, which examines which publishers the merging parties lose to the most often; (3) runner-up data, which shows how often the other party was the "runner-up" when one of the merging parties won an acquisition; and (4) minutes from the parties' editorial meetings, which provide a window into how frequently one merging party bid on a book and lost to the other party. Recognizing that each methodology has limitations, Dr. Hill performed multiple tests "to get a holistic understanding of what diversion might look like." Trial Tr. at 1294:20–1295:4. All the methodologies employed by Dr. Hill pointed to the same conclusion: that PRH is S&S's closest competitor, and that S&S is a significant competitor to PRH. Specifically, Dr. Hill's diversion ratios indicate that if PRH lowered advances, between 19 and 27 percent of its authors would divert to S&S; and that if S&S lowered advances, between 42 and 59 percent of its authors would divert to PRH. The government summarized the results of the four studies as follows:

Figure 7. Summary of Dr. Hill's Diversion Estimates (PX-970)

Type of Analysis	Diversion from PRH to S&S	Diversion from S&S to PRH
Diversion according to share	19%	42%
Win/loss data	19%	59%
Runner-up study	27%	59%
Editorial minutes	21%	54%

See Govt. PFOF-PCOL ¶ 274 (citing PX 970).

The defendants' expert, Professor Snyder, calculated his own diversion ratios, using a less reliable data set assembled from the records of eighteen agents who responded to subpoenas ("agency data").[26] Although Professor Snyder's ratios were lower, he also found that PRH is

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26 Professor Snyder's agency data is less comprehensive than Dr. Hill's data set. The eighteen literary agencies that provided information in response to subpoenas are only a subset of the agents in the industry. *See* Trial Tr. at 2657:7–25 (Snyder). Of the 973 contracts examined by Professor Snyder, from 2018 to 2021, only 360 earned advances per title of $250,000 or more. *See id.* Of those 360 contracts, Professor Snyder could not identify a clear runner-up in 61 instances. *See* Trial Tr. at 2658:12–15 (Snyder). The remaining pool of data, relatively small and unrepresentative as it was, *see* Trial Tr. at 1289:22–1292:12 (Hill), indicated that PRH and S&S were the winner

S&S's closest competitor. Professor Snyder determined that the diversion ratio from PRH to S&S is 20 percent, and the diversion ratio from S&S to PRH is 27 percent. Trial Tr. at 2927:4-25 (Snyder).

The competition between PRH and S&S benefits authors by increasing advances paid for their books, and industry participants predict that the loss of that competition would be harmful to authors. Kensington's CEO, Steven Zacharius, testified, "I personally would expect that [advances] would go down since there will be less competition for those authors." PX 2000 at 3. Macmillan's CEO Don Weisberg testified, "My guess is less competition will . . . long-term probably bring the advance levels down." *See* Trial Tr. at 1085:3–24. Agent Ayesha Pande testified, "I think overall [the merger] will limit the choice, the number of editors and imprints and publishing houses that would . . . be a good home for my clients. . . . And I believe overall advances for my clients would be suppressed." *See id.* at 295:3–16.[27]

The merger would cause an inarguable loss of competition from the elimination of situations where PRH and S&S would have been the top two or the only two bidders for an anticipated top seller. Dr. Hill calculates that this should happen in approximately 12 percent of

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and runner-up in only 7 percent of the cases, while market shares would have predicted that they would be winner and runner-up in 12 percent of the cases. *See* Trial Tr. at 1588:7–19 (Hill), 2797:20–2798:6 (Snyder). Notably, Professor Snyder's estimate of diversion from S&S to PRH is based on a sample of only 22 books over four years, the smallest sample of all the data sets used to estimate diversion. Trial Tr. at 1291:15–1292:12 (Hill), 1707:20–1708:1 (Hill); PX 996 at 1.

27 Defendants presented testimony to the contrary, suggesting that the lost competition between PRH and S&S would not harm authors or their advances; and that it instead might lead to an increase in advance levels. *See* Defs. PFOF ¶¶ 25–26 (suggesting that savings from the merger would allow the combined company to spend more money to acquire books, which in turn would force competitors to offer higher advances), 115–116 (stressing that PRH and competitors have no plans to lower advances). For example, S&S CEO Jonathan Karp testified that the company has no plans to decrease author advances or reduce title count post-merger, *see* Trial Tr. at 583:13–19; and PRH Head of Global Mergers & Acquisitions Manuel Sansigre did not consider the potential for reduced author compensation when projecting the merger's efficiencies for PRH, *see id.* at 2532:25–2533:12. In addition, HarperCollins CEO Brian Murray stated that his company had not discussed author advances decreasing due to the merger, *see id.* at 1407:24–1408:12; and that [redacted], *see id.* at 1447:3–19, 1452:9–14. The Court finds testimony that the merger will have either no effect or positive effects on advances incredible. The Court instead credits the much stronger evidence that advances will decrease after the merger, based on the market-share data, economic analyses, and the more credible testimony regarding market dynamics discussed *supra*.

book transactions based on market share, while Professor Snyder calculates that it happened only 6 to 7 percent of the time in his data set. *See id.* at 1588:7–19 (Hill), 2797:20–2798:6 (Snyder). The government's evidence included 27 summaries of competitive episodes, over three and a half years, in which PRH and S&S drove up advances through direct, head-to-head competition. *See id.* at 660:16–25 (Porro), 664:8–10 (Porro), 686:9–22 (Porro). For example, as the only two bidders for one book, PRH and S&S drove the advance offered from $6 million to $8 million. *See* PX 958-B. As the last two bidders for another book, PRH and S&S drove the advance offered from $685,000 to $825,000. *See* PX 941-B. The loss of such head-to-head match-ups undoubtedly would harm the authors whose advances would have been bid up by the direct competition. *See generally* Merger Guidelines § 6.2. The defendants argue, however, that the incidence of harm would be too infrequent to be considered substantial. *See* Defs. PCOL ¶¶ 58–65.

Even when the merging parties were not the top two bidders, S&S's participation strengthened competition across all auction formats — round-robin, best-bid, and hybrid. Hachette CEO Michael Pietsch testified that a larger number of bidders leads to "more upward pressure" so that "in general . . . the price paid at auction can increase because of the number of participants." *See* Trial Tr. at 181:7–11 (Pietsch). Dr. Hill confirmed that when a large number imprints participate in an auction, all of them understand that they need to be more aggressive in their bidding to prevail. *See id.* at 1268:2–8 (Hill) ("So this is a correlation between when you have a large number of bidders, you may need to be more aggressive in your bidding.");[28] *see*

[28] Dr. Hill gave two examples that demonstrate how the number of bidders influences a publisher's bidding strategy in best-bids auctions. In a 2019 best-bids auction for a young adult novel, an S&S editor wrote that, because there were only three bidders, "I think we can be more guarded in our bidding." *See* Trial Tr. at 1267:15–22 (Hill). In a 2020 best-bids auction for a book by a musician, a PRH editor wrote, "Another editor and I discussed bringing our offer significantly down yesterday based on the sense I got from the agent that she doesn't have many interested bidders." *See id.* at 1267:23–1268:1 (Hill).

also Anthem, 236 F. Supp. 3d at 220–21 ("reducing the number of national carriers from four to three is significant" because of its likely effect on bidding behavior). A higher number of bidders also increases the chances that an author will receive an "outlier" high bid. A book's perceived value may vary significantly among different editors and publishers, and an unusually high bid for a book is likelier when there are more bidders. *See* Trial Tr. at 601:20–25 (Karp), 1305:18–1306:3 (Hill), 2109:3–21 (Wylie). In one notable example, one bidder offered an advance four times higher than the next closest bidder, reflecting the winner's unique view of the book's potential. *See id.* at 2931:16–2933:19 (Snyder). The loss of S&S as an independent bidder would weaken bidding incentives and reduce the frequency of events like these.

As previously noted, competition among publishers influences advances even in individual negotiations between an agent and one publisher. *See supra* Section I.C. That is because publishers know that agents can shop the book to other publishers if the publisher's offer is not high enough. *See id.* Therefore, the loss of PRH as an outside competitor would weaken authors' leverage in one-on-one negotiations with S&S, and the loss of S&S as an outside competitor would weaken authors' leverage in one-on-one negotiations with PRH. This conclusion is consistent with Dr. Hill's expert testimony, *see* Trial Tr. at 1270:13–1271:18 (Hill), as well as the Merger Guidelines. *See* Merger Guidelines § 6.2 ("A merger between two competing [buyers] prevents [sellers] from playing those [buyers] off against each other in negotiations.").

Finally, the evidence suggests that the acquisition of S&S would reduce PRH's motivation to compete for publishing rights. PRH CEO Markus Dohle testified that there are two ways to increase market share in the industry: publish more successful books or acquire other companies that publish successful books. *See* Trial Tr. at 801:18–23. PRH has most recently pursued a strategy of bidding more aggressively and acquiring more "big books" to organically increase its market share. *See id.* at 800:15–801:3 (Dohle), 2259:5–20 (McIntosh). The acquisition of S&S would give PRH an alternative means of increasing its market share that would remove the pressure on PRH to acquire more books. *See id.* at 802:11–18 (Dohle). Thus, accomplishing its goal of increasing market share through the merger would cause PRH to bid less aggressively for books than it otherwise would. *See id.* (Q: "After this merger, Penguin Random House will not have as strong a need to grow its share?" Dohle: "Yes.").

b. Economic Models

Dr. Hill used economic models to attempt to quantify the expected harm to authors from the merger. He conceded that the models are imprecise and do not perfectly reflect the way books are acquired in the publishing industry; but he performed the analyses to glean additional information about the likelihood of anticompetitive harm. *See id.* at 1653:25–1654:9 (Hill). Dr. Hill's primary model predicts that the merger would cause advances for PRH authors to decrease by about 4 percent (or $44,000); and would cause advances for S&S authors to decrease by 11.5 percent (or $105,000). *See id.* at 1312:10–20 (Hill); PX 964 at 1–2. Although the defendants challenge the applicability of the models and some of the inputs used by Dr. Hill, they fail to convince the Court that the models are worthless. The economic models generally corroborate the other evidence in the record that author advances would decrease in the wake of the merger.

Dr. Hill primarily relied on a "second-score auction" model to quantify the merger's potential harm to authors. *See id.* at 1295:21–22 (Hill). The model assumed that all book rights are allocated using auctions, *see id.* at 1298:13–1302:19 (Hill); and it used a market-share input to estimate how often the merging parties would be the top two bidders in an auction, *see id.* at 1305:9–17 (Hill). The model used an input of variable-profit margins to estimate the variation among the bids: Using higher variable-profit margins generally would cause the model to predict greater harm, *i.e.*, a bigger decrease in advance level.[29] *See id.* at 1305:18–1306:3 (Hill). To measure the effect of the merger, the model looked at the instances when the merging parties would be the top two bidders and then eliminated the second-highest bid, thereby making the third-place bid the one that would set the amount of the advance (on the theory that the winning bid would now only need to beat the third-place bid). *See id.* at 1303:7–22 (Hill).

The defendants argue that Dr. Hill's second-score auction model is flawed because (1) it inaccurately assumes that all book transactions involve auctions, and (2) Dr. Hill used the wrong input for variable-profit margins. *See* Defs. PFOF ¶ 215; Defs. PCOL ¶¶ 106–121; ECF No. 183 (Defs. Objections to Govt. PFOF-PCOL) at 29–36. Although the defendants are correct that the model does not precisely reflect how book contracts are allocated among publishers, its exclusive reliance on auctions is a reasonable simplification. *See* Trial Tr. at 1296:16–21 (Hill) (explaining why he interprets the model more broadly). The market-share data captures the rate at which the parties are winning book contracts — through negotiations, auctions or otherwise; and market shares also reasonably predict how often the merging parties would be the winner and runner-up. *Compare* PX 970, *with* Trial Tr. at 2927:8–25 (Snyder) (diversion according to share produces diversion ratios broadly consistent with Dr. Hill's runner-up study and Professor Snyder's agency data). Moreover, as previously discussed, competition affects advance levels even in one-on-one negotiations, so the model's use of auctions to simulate the result of negotiations has some basis in market reality. Finally, similar or identical models have been used in other antitrust cases involving industries that feature negotiations. *See Wilhelmsen*, 341 F. Supp. 3d at 64–65; *Anthem*, 236 F. Supp. 3d at 217–20; *Sysco*, 113 F. Supp. 3d at 24, 66–67 (noting that

29 Variable-profit margin is equal to revenue minus variable costs. The metric does not account for, *i.e.*, subtract, fixed costs. See Trial Tr. at 1310:2–25 (Hill).

customers were awarded contracts through "a request for proposal or bilateral negotiations"). The Court understands that the second-score auction model provides only a rough approximation of expected harm but nevertheless finds it useful. As for Dr. Hill's allegedly mistaken inclusion of fixed costs in some of his variable-profit margins, that was the more conservative approach: Including the extra costs lowered the margins and reduced the model's prediction of harm. *See* Trial Tr. at 1311:18–1312:6 (Hill). Although Professor Snyder also suggested that Dr. Hill should have included fixed costs in all the variable-profit margins, *see id.* at 3027:5–3030:4 (Snyder), Dr. Hill explained that the model explicitly calls for the use of variable, not fixed, costs.[30]

In response to Professor Snyder's criticism that the second-score auction model was a poor fit for the publishing industry, Dr. Hill also ran a series of models based on the "gross upward pricing pressure index" (GUPPI). *See id.* at 1315:16–1316:10 (Hill). The GUPPI models use diversion ratios and margins as inputs, with higher diversion ratios and higher margins leading to a higher prediction of harm. *See id.* at 1318:2–7 (Hill); *see also supra* Section III.B.2.i.a (explaining diversion ratios). But the GUPPI models used by Dr. Hill are more difficult for the defendants to challenge because those models were originally adopted by the defendants' own economists during the pre-complaint investigation of the instant merger. *See* Trial Tr. at 1633:15–23 (Hill). The GUPPI models also predict a reduction in author advances due to the merger, across different auction formats and using various diversion ratios, including those calculated by Professor Snyder. The government summarized Dr. Hill's findings as follows:

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30 Both the second-score auction model and the GUPPI models, discussed *infra*, are "explicit" that one should use firms' variable, not fixed, costs to implement the models. Trial Tr. at 3092:23–3093:15 (Hill). This is because the models assume that publishers ask whether the marginal profits of acquiring one more book exceed the marginal costs. *See id.*

Figure 8. Dr. Hill's Estimates From Second-Score Auction and GUPPI Models (PX-964)

Model	Diversion Assumption	% Reduction in Author Compensation	
		PRH	S&S
Second-score auction model	Diversion according to share	4.3%	11.6%
Multi-round auction GUPPI	Diversion according to share	7.3%	19.2%
Multi-round auction GUPPI	Snyder diversion ratios	7.4%	12.8%
Single-round and hybrid GUPPI	Diversion according to share	3.7%	9.6%
Single-round and hybrid GUPPI	Snyder diversion ratios	3.7%	6.4%

See Govt. PFOF-PCOL ¶ 288 (citing PX 964). There is ample precedent for using GUPPI and similar models to predict harm in antitrust cases. *See Wilhelmsen*, 341 F. Supp. 3d at 64; *Anthem*, 236 F. Supp. 3d at 212; *see also FTC v. Sanford Health*, No. 1:17-cv-133, 2017 WL 10810016, at *12–13 (D.N.D. Dec. 15, 2017), *aff'd.*, 926 F.3d 959 (8th Cir. 2019).

iii. Coordinated Effects

Another avenue for the government to prove competitive harm is by showing a likelihood of "coordinated effects," which occur when market participants mutually decrease competition in the relevant market. *AT&T*, 310 F. Supp. 3d at 246 ("A proposed merger may violate Section 7 by enabling or encouraging post-merger coordinated interaction among firms in the relevant market that harms customers." (cleaned up)); *see also* Merger Guidelines § 7 ("Coordinated interaction involves conduct by multiple firms that is profitable for each of them only as a result of the accommodating reactions of the others."). Coordinated effects can arise from an express or implied agreement among competitors, *see CCC Holdings*, 605 F. Supp. 2d at 60; or from "parallel accommodating conduct" among competitors without a prior agreement, Merger Guidelines § 7. Parallel accommodating conduct involves "situations in which each rival's response to competitive moves made by others is individually rational, and not motivated by retaliation or deterrence nor intended to sustain an agreed-upon market outcome, but nevertheless emboldens price [decreases] and weakens competitive incentives to [raise advances] or offer [authors] better terms." *Id.*

Coordinated effects are likelier in concentrated markets; indeed, the idea that concentration tends to produce anticompetitive coordination is central to merger law. *See Heinz*, 246 F.3d at 716 ("Merger law 'rests upon the theory that, where rivals are few, firms will be able to coordinate their behavior, either by overt collusion or implicit understanding, in order to restrict output and achieve profits above competitive levels.'" (quoting *FTC v. PPG Indus.*, 798 F.2d 1500, 1503 (D.C. Cir. 1986)). Therefore, when the government has shown that a merger will substantially increase concentration in an already concentrated market — as it has done here, *see supra* Section III.B.1 — "the burden is on the defendants to produce evidence of 'structural market barriers to collusion' specific to this industry that would defeat the 'ordinary presumption of collusion' that attaches to a merger in a highly concentrated market." *H & R Block*, 833 F. Supp. 2d at 77 (quoting *Heinz*, 246 F.3d at 725).

As an initial matter, a history of collusion or attempted collusion is highly probative of likely harm from a merger. *See Hosp. Corp.*, 807 F.2d at 1388; *see also FTC v. Elders Grain, Inc.*, 868 F.2d 901, 906 (7th Cir. 1989) ("[A]n acquisition which reduces the number of significant sellers in a market already highly concentrated and prone to collusion by reason of its history and circumstances is unlawful in the absence of special circumstances."); *H & R Block*, 833 F. Supp. 2d at 78; *Tronox*, 332 F. Supp. 3d at 208–210; Merger Guidelines § 7.2. Thus, it is significant that in *United States v. Apple, Inc.*, the Second Circuit upheld a finding that between 2009 and 2012, all the "Big Six"[31] publishers, except for Random House, participated in a

[31] This was before Penguin Books and Random House merged, so there was a "Big Six" instead of a "Big Five."

"horizontal conspiracy . . . to raise e[-]book prices." *See* 791 F.3d at 339. This coordination involved "numerous exchanges between executives at different Big Six publishers," "constant communication" among the publishers "regarding their negotiations with both Apple and Amazon," and "frequent telephone calls among the Publisher Defendants." *Id.* at 302, 318. "[T]he Big Six operated in a close-knit industry and had no qualms communicating about the need to act together." *Id.* at 300. The Second Circuit concluded that the publishers engaged in "express collusion" that was a *per se* violation of antitrust law. *Id.* at 316, 321–29. Although Random House did not participate in the conspiracy, Penguin Books and S&S both did, *see id.* at 308, and this "history of successful cooperation establishes a precondition to effective collusion — mutual trust and forbearance." *See Hosp. Corp.*, 807 F.2d at 1388. The case portrays an industry already "prone to collusion," which may become "even more prone to collusion" after the proposed merger of its largest and third-largest competitors. *See Elders Grain*, 868 F.2d at 905–06.

The *Apple* case provides the backdrop for trends in the industry that appear to demonstrate that the Big Five are already engaging in tacit collusion or parallel accommodating conduct when acquiring books. Recent years have seen the industry-wide standardization of certain contract terms — involving payment structure, audio rights, and e-book royalties — in ways that favor publishers over authors, suggesting that the top publishers have engaged in coordinated conduct. Advances used to be paid to authors in two installments, but publishers uniformly moved to paying them in three installments and then four installments, thereby delaying authors' compensation. *See supra* Section I.B. After audiobooks became a significant source of revenue in the industry, publishers uniformly refused to acquire books without audio rights included, thereby limiting authors' ability to maximize their compensation and preventing authors from diversifying their sources of income. *See id.* In addition, during the early years of e-books, publishers uniformly shifted e-book royalty rates from 50 percent to 25 percent, thereby reducing authors' compensation. *See* Trial Tr. at 774:6–776:21 (Dohle). Thus, in an industry where the competition to acquire anticipated top sellers is intense, the competing publishers nevertheless choose, almost always, not to gain advantage by offering more favorable contract terms. This phenomenon bespeaks a tacit agreement among the publishers to compete only on the basis of advance level because it collectively benefits them not to yield on other contract terms. *Accord H & R Block*, 833 F. Supp. 2d at 77–78 ("[A] highly persuasive historical act of cooperation between [competitors]" supports the theory that "coordination would likely take the form of mutual recognition that neither firm has an interest in an overall 'race to free' . . . .").

One example involving audio rights is illustrative. When selling the publishing rights to [redacted] highly sought-after book, her agent attempted to hold an auction that excluded audio rights. S&S wanted the book but refused to bid because "[t]he only way to prevent agents from breaking off audio rights like this is to hold firm to our policy of no deals without audio rights." PX 652 at 2. An S&S editor ruminated, "It will be very interesting to see whether PRH, Hachette, Harper or Macmillan participate. M[y] understanding is that they too have the 'no audio, no deal' rule." *Id.* The agent was forced to restart the auction with audio rights included, *see* PX 568 at 3, presumably because the book received insufficient offers or only received offers that included audio. *See* PX 320 at 1 (in the first round, PRH bid for bundled audio rights in violation of the auction's initial rules). In the renewed auction that included audio rights, the bidding was fervid and reflected vigorous competition.[32] This episode starkly demonstrates that

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32 As previously discussed, there were six rounds of bidding between four bidders, with a high bid of $400,000 in the first round and a winning bid of $775,000 from PRH's Viking imprint, which was $75,000 more than Viking's initial bid clearance. *See supra* Section I.C.

the publishers, despite their great enthusiasm for the book, initially engaged in parallel conduct to deny the author the ability to exclude audio rights from the auction. The parallel conduct was effective and mutually beneficial, as the publishers all retained the opportunity to acquire the book, with their preferred contract term concerning audio rights. Based on this evidence, the Court finds that the Big Five publishers have engaged in tacit coordination that is profitable for those involved.

Finally, it is significant that in a market already prone to collusion, where coordinated conduct already appears to be rampant, PRH's acquisition of S&S would reinforce the market's oligopsonistic structure and create a behemoth industry leader that other market participants could easily follow. *See* PX 80E (translation of PX 80, materials for Bertelsmann board presentation) at 13 (describing publishing industry as an oligopoly). The Big Five publishers already control 91 percent of the relevant market. *See* PX 963. The merger would distill the Big Five to a Big Four, with an overwhelmingly dominant top firm, PRH-S&S, controlling 49 percent of the market and dwarfing its nearest competitors. In the newly reconfigured market, the top two firms, the merged entity and [redacted] would have a 74-percent market share. *See id.* Under such circumstances, coordinated effects are likely through "sheer market power" because the "post-merger market would feature two firms that control roughly three quarters" of the market. *Tronox*, 332 F. Supp. 3d at 209; *see also Heinz*, 246 F.3d at 724 n.23 (recognizing that "price leadership" is "a danger" in a "duopoly" market). The merger would thus increase the market's already high susceptibility to coordination. *See* Trial Tr. at 1329:18–21 (Hill).[33]

[33] Other factors that courts have found relevant to an evaluation of the likelihood of coordinated effects include: differentiated products, transparent competitive outcomes, punishment mechanisms, and frequent purchases for small amounts. *See H & R Block*, 833 F. Supp. 2d at 77–79; *CCC Holdings*, 605 F. Supp. 2d at 62; *Arch Coal*, 329 F. Supp. 2d at 144–45 . The Court sees no need to march through a discussion of those factors. Merger analysis is industry-specific and fact-intensive. *See Brown Shoe*, 370 U.S. at 321–22 ("Congress indicated plainly that a merger had to be functionally viewed, in the context of its particular industry." (footnote omitted)). Where, as here,

C. Rebuttal

The government is entitled to a presumption of anticompetitive effects and has also met its burden to establish a prima facie case. The defendants, therefore, now have the burden to rebut the government's case by "show[ing] that the prima facie case inaccurately predicts the relevant transaction's probable effect on future competition." *See Baker Hughes*, 908 F.2d at 981. It is the defendants' task to demonstrate that the market shares and the associated presumption of illegality inaccurately reflect competitive reality. *See id.*; *see also Heinz*, 246 F.3d at 715 ("To rebut the presumption, the defendants must produce evidence that shows that the market-share statistics give an inaccurate account of the merger's probable effects on competition in the relevant market." (cleaned up)).

"There is no science to weighing the factors at play in an antitrust analysis," and the defendants may rebut the government's prima facie case with any relevant "real-world evidence." *RAG-Stiftung*, 436 F. Supp. 3d at 312. For example, the defendants may meet their burden of rebuttal by demonstrating low barriers to entry in the relevant market, *see, e.g.*, *Wilhelmsen*, 341 F. Supp. 3d at 68; *Staples II*, 190 F. Supp. 3d at 133; or sophisticated counterparts (here, authors and agents) who can blunt the impact of consolidation, *see, e.g.*, *RAG-Stiftung*, 436 F. Supp. 3d at 315.

"[B]ecause the burden of persuasion ultimately lies with the plaintiff, the burden to rebut must not be 'unduly onerous.'" *United States v. Anthem, Inc.* ("*Anthem II*"), 855 F.3d 345, 350 (D.C. Cir. 2017) (quoting *Baker Hughes*, 908 F.2d at 981, 991). However, "[t]he more compelling the prima facie case, the more evidence the defendant must present to rebut it

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there is a strong risk of collusion based on history, current practices, and extreme market concentration, the Court finds it unnecessary to explore peripheral issues.

successfully." *See Baker Hughes*, 908 F.2d at 991. Here, the government has "made out a strong prima facie case" based on the highly concentrated market and affirmative evidence of likely anticompetitive effects. *See Wilhelmsen*, 341 F. Supp. 3d at 66. The defendants, therefore, "must make out a correspondingly strong rebuttal showing." *See id.*

1. Existing Competition

The defendants assert that existing competition can and will constrain the merged company more than market shares or the government's evidence would suggest. *See, e.g.*, *Sysco*, 113 F. Supp. 3d at 78. The defendants point to competition from other publishers, competition from self-publishing, and internal competition within publishing houses. *See* Defs. PFOF ¶¶ 115–23, 164–85, 198–213; Defs. PCOL ¶¶ 74–79.

i. Other Publishers

The defendants argue that a combined PRH and S&S would be constrained by other publishers, who do not plan to lower their advance offers or change their bidding strategies. *See* Defs. PFOF ¶¶ 115–23; Defs. PCOL ¶¶ 74–76. For example, HarperCollins's CEO Brian Murray testified that his company would not "hold back" in competing with the merged entity. *See* Trial Tr. at 1385:9–15 (Murray). Consistent with that testimony, HarperCollins did not project a decrease in its title count or its advance spending after the PRH-S&S merger was announced. *See* DX 279 (HarperCollins strategy presentation for 2022) at 25. The CEOs of other competitors, including Hachette and [redacted] also stated that they would not change their bidding strategies in response to the merger. *See* Trial Tr. at 211:9–13 (Hachette CEO Michael Pietsch); [redacted]) at 31. Therefore, the defendants argue, other existing publishers stand ready to prevent any unilateral anticompetitive effects from the merger.

The defendants' reliance on such assurances from their competitors is insufficient. It is not necessary for other publishers to change their maximum advances or bidding strategies for anticompetitive unilateral effects to occur. First, and most obviously, with respect to book acquisitions where PRH and S&S would have been the winner and runner-up, the merged entity will acquire such books for lower advances regardless of the other publishers' bids. *See supra* Section III.B.1, Section III.B.2.i.

Second, in situations where PRH or S&S would have won a book, regardless of the runner-up, the merged entity might submit a lower bid due to its decreased motivation to achieve organic growth. *See supra* Section III.B.2. In such a case, another publisher could win the book instead, for a lower advance than what PRH or S&S would have offered as standalone entities.

Third, publishers do not immediately offer their maximum advance when attempting to acquire books; moreover, they initially offer higher advances when they think there is more competition, and lower advances if they think there is less competition. *See supra* Section III.B.2.i.a; *see also* Trial Tr. at 499:6–500:12 (Karp), 1267:13–1268:8 (Hill). The general softening of competition with the elimination of S&S as a standalone bidder, leading to the perception of less competition in book acquisitions, would likely lead publishers to make lower initial advance offers. *See supra* Section III.B.2. If subsequent bids that would have come from PRH or S&S as separate entities are not forthcoming, or are lower than they otherwise would have been, the other publishers could acquire books for lower advances simply by following their existing bidding strategy.

Fourth and finally, it is not necessary for advances to decline in absolute terms for authors to be harmed. The relevant market has been growing rapidly in recent years in response to strong consumer demand, and advances have been rising, consistent with that growth. *See* PX

2002 (Stehlik) at 16–17; DX 422 (Glusman) at 37–38; Trial Tr. at 991:5–19 (Tart), 1990:4–9 (Kim). If the merger goes through, the rate of growth might be offset by competitive harm, allowing publishers to acquire books for more than they do now but for less than they would have absent the merger. That would result in harm to authors even if there were no decline in advances, or even if there was some (slowed) growth in the total advances paid.

The defendants also argue that non-Big Five publishers would be a significant competitive constraint on a combined PRH and S&S. *See* Defs. PFOF ¶¶ 164–80; Defs. PCOL ¶¶ 74–76. The evidence shows, however, that the smaller publishers lack the resources to compete regularly in the market for anticipated top-selling books. *See supra* Section I.C; Trial Tr. at 2047:13–18 (Cheney). Individual publishers outside the Big Five rarely acquire books for advances at or above $250,000. *See* PX 963.

The defendants take the novel approach of aggregating all the non-Big Five publishers and characterizing them as a single force with a 9-percent market share — which allegedly makes their collective power to constrain the merged company comparable to that of a Big Five publisher. *See* Defs. PFOF ¶ 164 ("When aggregated, the non-Big-Five publishers are as likely to win as [redacted] . . . ."); Defs. PCOL ¶ 64 (arguing that an "effective 6-5 merger (based on market shares) [is] at issue here"); *see also* Trial Tr. at 2906:10–2907:14 (Snyder).[34] The defendants offer no precedent to support this economic sleight of hand, and the methodology appears dubious. If market shares can be so readily manipulated by aggregating unaffiliated companies, why not aggregate all the publishers that are not PRH and S&S into a single, massive counterweight with a 51 percent market share? The defendants' approach appears incompatible with the way antitrust law approaches market concentration and its presumed effects on

[34] Although Dr. Hill combined the non-Big Five's market shares in his economic models as a reasonable simplification, *see* Trial Tr. at 3081:12–23 (Hill), he did not treat them as one competitor in his overall analysis.

competition. *See supra* Section III.B.1. Generally, a firm with lower market share is assumed to wield less market power, and market concentration would be considered low in an industry with many individual firms with small market shares. *See* Merger Guidelines § 5.3 ("The Agencies may measure market concentration using the number of significant competitors in the market. This measure is most useful when there is a gap in market share between significant competitors and smaller rivals . . . ."). For example, applying a HHI analysis shows that 100 firms that each have a 1-percent market share (which would produce an HHI of 100) do not represent the same competitive landscape as two firms that each have a 50-percent market share (which would produce an HHI of 5000).[35] Indeed, the government points out that aggregating the non-Big Five publishers does not help the defendants' case because it yields a higher HHI and depicts a more concentrated market. *See* Govt. PFOF-PCOL ¶ 134.

Professor Snyder gave counterintuitive and apparently erroneous testimony about the significance of non-Big Five bidders in competitive auctions. He claimed that the non-Big Five publishers, with a combined market share of 9 percent, are nevertheless the winner or runner-up in 23 percent of auctions for anticipated top-selling books; while PRH and S&S, with a combined market share of 49 percent, are the winner and runner-up only seven percent of the time. *See* Trial Tr. at 2689:22–2690:5 (Snyder), 2827:13–23 (Snyder). The Court finds the 23-percent figure unreliable because it was the subject of much contradictory testimony at trial, including the credible assertion by Dr. Hill that the number should be halved. *See id.* at 3051:16–3053:17 (Hill). And overall, Professor Snyder's reliance on the limited and unrepresentative "agency data" weakened the credibility of his analyses. *See supra* Section

[35] Summing the squares of each firm's market share, the first HHI is calculated as $100 \times 1^2 = 100$, and the second HHI is calculated as $2 \times 50^2 = 5000$. *See supra* Section III.A.2.

III.B.2 (note 26). Thus, the defendants' expert fails to cast doubt on the reliability of the market-share statistics presented by the government. *See Heinz*, 246 F.3d at 715.

ii. Internal Competition

The defendants argue that internal imprint competition increases competition in the market beyond that represented in market shares. *See* Defs. PFOF ¶¶ 198–213; Defs. PCOL ¶¶ 77–79. That argument is undermined by the presumption that "[c]ompanies with multiple divisions must be viewed as a single actor, and each division will act to pursue the common interests of the whole corporation." *AT&T*, 916 F.3d at 1043. This presumption "was adopted as a principle of antitrust law," *id.*, in *Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752, 771 (1984) ("[T]he coordinated activity of a parent and its wholly owned subsidiary must be viewed as that of a single enterprise . . . . A parent and its wholly owned subsidiary have a complete unity of interest."). Consistent with economic principles and common sense, internal imprint competition should be considered only to the extent that it maximizes the profits of the publishing house. *See* Areeda, *Antitrust Law* ¶ 964b ("Antitrust law generally presumes that a firm maximizes its profits in the environment in which it finds itself . . . .").

Although internal competition among imprints is currently permitted by some publishers in round-robin auctions, such competition is far from unrestrained. To the extent imprints compete internally within the confines of a house bid, they can provide more editorial choices to authors, but there is no price competition that allows authors to achieve the highest possible advance level. *See supra* Section I.C. Even this non-price competition is discouraged. *See* DX 71 at 2 (email from S&S CEO Karp regarding editor guidelines) ("Duplicating work is not a productive expenditure of one of our most valuable resources — time. You can acquire more books if you aren't all chasing the same ones . . . . Try to bail out on submission in which there are more than two imprints in the building pursuing the project."). In cases where internal imprints do compete financially, such competition is confined to situations where there is an external bidder. Moreover, as previously discussed, there are numerous examples in the record of PRH using "background coordination in auctions to . . . avoid internal up-bidding." PX 411 at 4; *see also* Trial Tr. 2372:17–2373:8 (McIntosh); *supra* Section I.C. Thus, internal competition would have a very limited impact in mitigating anticompetitive effects in the industry. To achieve the highest advances for authors, internal imprint competition is no substitute for competition among independent publishers.

The defendants assert that the merged company would go even farther in permitting internal competition than current policies allow. *See* Defs. PFOF ¶ 210; DX 236. They note that PRH CEO Dohle has promised, in a letter to agents, that S&S legacy imprints will bid against PRH imprints even when there are no external bidders. *See* Defs. PFOF ¶ 210; DX 236. The Court gives no weight to this unenforceable promise. Indeed, the promise calls to mind the criminal-law concept of "consciousness of guilt": Mr. Dohle's extraordinary pledge appears to reflect his awareness of how threatening the combined entity would be to authors and agents. The promise lacks credibility for three reasons:

First, the proposed policy would not be profit-maximizing and is thus unreliable evidence of future conduct. *See* Areeda, *Antitrust Law* ¶ 964b. It is unclear how the new feature of the policy — allowing internal competition even without an external bidder — would financially benefit the combined entity. Instead, it appears that the promise was made just to get the deal done, and once the merger is executed, there will be no economic incentive to maintain the policy.

Second, the promise can be broken at will. Mr. Dohle, his successor, or his superiors could legally change or rescind the new policy at any time. The defendants argue that such behavior would harm the merged entity because of backlash from agents, *see* Defs. PFOF ¶ 210, but evidence shows that agents have limited power over the large publishing houses, *see infra* Section III.C.3.i. A unilateral promise by PRH that it will not use its market power if it acquires S&S cannot rebut the government's prima facie case. *See H & R Block*, 833 F. Supp. 2d at 82 (Even if "the Court has no reason to doubt that defendants would honor their promise [to maintain the acquired firm's current prices for three years post-merger], this type of guarantee cannot rebut a likelihood of anticompetitive effects in this case.").

Third, the promise would not prevent the merged entity from reducing internal imprint competition. Despite the promise, PRH could coordinate bids with legacy S&S imprints in the same way that PRH currently does among its own imprints. *See supra* Section I.C. The promise also would not stop the merged company from consolidating PRH and legacy S&S imprints, as PRH did when it reorganized the divisions within Random House in 2019, so that "there [would] be less internal competition with[in] the focused editorial profiles in [its] divisions." *See* PX 241. Finally, the merged entity could direct its imprints to focus on non-competing genres, thereby preventing the imprints from pursuing the same books. *See id.* For all the foregoing reasons, Mr. Dohle's promise does little to rebut the government's prima facie case or the presumption of anticompetitive effects.

iii. Self-Publishing

The defendants argue that self-publishing is a competitive constraint on the market, particularly for celebrity and romance authors.[36] *See* Defs. PFOF ¶¶ 181–85; *see also* Trial Tr. at 566:1–11 (Karp). But, as previously discussed, self-publishing is not a reasonable substitute for traditional publishers in the market for anticipated top-selling books. *See supra* Section I.C, Section II.A.2. Anecdotes about author Brandon Sanderson raising $40 million on Kickstarter, or author Colleen Hoover having success with self-publishing, do not change the overall picture of the industry. Sanderson's success with self-publishing was "rare," "a feat," and "so incredible." Trial Tr. at 1076:4–10 (Weisberg), 1077:4–7 (Weisberg). Similarly, Hoover is "a cultural phenomenon" and "the hottest author in the country." *Id.* at 524:18–25 (Karp), 560:5–10 (Karp). Sanderson and Hoover are exceptions that prove the rule: For the overwhelming majority of authors in the relevant market, self-publishing is no real substitute for using a publishing house, and self-publishing therefore does little to constrain anticompetitive effects.

2. *Barriers to Entry and Expansion*

The defendants argue that there are few barriers to entry that would prevent new or existing publishers from competing effectively with the merged company. *See* Defs. PFOF ¶¶ 69, 124–48; Defs. PCOL ¶¶ 80–83. New entrants to the market would presumably give authors alternative outlets to publish their books, thereby preventing the merged entity from lowering advances. "The existence and significance of barriers to entry are frequently . . . crucial considerations in a rebuttal analysis. In the absence of significant barriers, a company probably cannot maintain [sub]competitive pricing for any length of time." *Baker Hughes*, 908 F.2d at

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36 Defendants admitted in their closing argument that self-publishing was not a true option for authors. *See* Trial Tr. at 3272:17–25 (arguing that hypothetical monopsonist test is "utterly meaningless other than addressing whether there's an outside option in the form of self-publishing, which nobody was arguing in this case"). In their post-trial briefing, however, they surprisingly assert that self-publishing is a competitive threat.

987. To constrain the new entity, "entry [by new competitors] must be timely, likely, and sufficient in its magnitude, character, and scope to deter or counteract the competitive effects of concern." *Wilhelmsen*, 341 F. Supp. 3d at 66–67 (quotations omitted). "The expansion of current competitors is regarded as essentially equivalent to new entry, and is therefore evaluated according to the same criteria." *Id.* at 66 (quotations omitted).

Contrary to the defendants' contentions, the evidence demonstrates that there are substantial barriers to entry and expansion in the publishing market for anticipated top-selling books. Established publishers have many advantages that are not easily replicated, including: (1) back lists that generate substantial and consistent revenue, which in turn supports risky acquisitions of high-advance books, *see* Trial Tr. at 156:5–157:14 (Pietsch); (2) large and effective marketing, sales, and distribution teams that have relationships with media and retailers, *see* [redacted] at 6–7; (3) excellent reputations and track records of success that attract authors, *see* Trial Tr. at 454:11–22 (Karp); and (4) lower variable costs due to economies of scale, *see id.* at 2047:16–18 (Cheney); *see also* Section I.C. In addition, numerous publisher witnesses expressed concern about a lack of access to sufficient printing capacity, which limits the number of books that publishers can physically produce and thus limits opportunity for expansion. *See id.* at 758:3–5 (Dohle), 121:8–19 (Pietsch), 364:1–9 (Eulau); [redacted] at 3. Industry insiders, including PRH executives, candidly acknowledged in trial testimony and ordinary-course documents that barriers to entry are high in the publishing business. *See* Trial Tr. at 168:9–169:1 (Pietsch), 755:4–15 (Dohle), 1380:12–1381:8 (Murray); PX 80-E at 13; PX 79 (presentation by PRH executives on publishing industry) at 8.

The best proof that would-be new competitors face formidable barriers to entry is the stability of market shares in the industry: No publisher has entered the market and become a strong competitor against the Big Five in the past thirty years. *See* Trial Tr. at 163:2–6 (Pietsch). Moreover, the Big Five's market share in acquiring anticipated top-selling books has remained stable for the past three years. *See* PX 967. Thus, there is little evidence that new or existing publishers will grow at a pace and magnitude that would allow them to discipline a merged PRH and S&S. *See Wilhelmsen*, 341 F. Supp. 3d at 68 ("The fact that the merging parties have been able to maintain high margins and market shares without witnessing notable entry and expansion suggests that . . . the market . . . is characterized by significant barriers to entry." (cleaned up)); Merger Guidelines § 5.3 ("The Agencies give more weight to market concentration when market shares have been stable over time . . . ."). The Big Five's market shares are built on "decades of credibility and success," Trial Tr. at 454:11–22 (Karp), and they cannot be easily challenged by less-established publishers.

Although the defendants argue that social media like "BookTok"[37] and Amazon's online bookstore level the playing field for smaller publishers, those platforms are not new and are far from "game-changing." *See id.* at 1069:1–4 (Weisberg) ("[T]his is the business of one-to-one word of mouth. It's never been anything else and it's still not, just the devices have changed."). Despite the current availability of "BookTok" and virtual storefronts, the Big Five still consistently acquire the publishing rights for 91 percent of anticipated top-selling books, demonstrating that the playing field has not been leveled in any meaningful way. *See* PX 994. For example, PRH utilizes its superior resources to maximize sales even on Amazon. *See supra*

[37] BookTok refers to activity on the social media platform TikTok where users review and promote books to one another. *See* Trial Tr. at 1414:12–16 (Weisberg).

Section I.C (PRH hires data scientists to study Amazon's search algorithms and spends money to get books better positioned in Amazon's search results.).

The defendants nevertheless point to new entrants like Zando, Spiegel & Grau, and Astra House, which have had some success in acquiring publishing rights to anticipated top-selling books. *See* Defs. PFOF ¶¶ 129–32, 144, 147. Although those publishing houses are associated with successful and well-respected editors, they lack many of the other advantages enjoyed by the Big Five: big back lists; extensive marketing, sales, and distribution teams; and scale. As a result, those new entrants have barely made a dent in the relevant market — their collective share is less than one percent, *see* PX 968, and no one in the industry views them as substantial competitors to the Big Five. *See* Trial Tr. at 249:20–250:90 (Pande), 552:21–557:3 (Karp). Moreover, the growth of those new competitors was accompanied by a countervailing shrinkage in the market shares of other non-Big Five publishers: The stability of the overall market share of non-Big Five publishers indicates that the new entrants have done little to change the competitive landscape, and that barriers to entry and expansion remain high. *See id.* at 1482:15–1483:17 (Hill); PX 977.

The defendants contend that Big Five rivals like HarperCollins and well-funded companies like Disney are poised to expand in the relevant market. *See* Defs. PFOF ¶¶ 124–48; Defs. PCOL ¶¶ 81–83. To be sure, Big Five rivals face low barriers to expansion because they have many of the same advantages that PRH and S&S have. But there is no evidence that HarperCollins, Hachette, or Macmillan could or would compete more aggressively with the merged company. *See* Trial Tr. at 177:1–15 (Pietsch), 1088:8–14 (Weisberg), 1385:9–1386:11 (Murray). The distribution of market shares among PRH, S&S, and the other Big Five publishers, has remained relatively constant in recent years. *See* PX 994. The Court has every reason to believe that all the industry players are already doing their best to compete; it is therefore unlikely that the non-merging Big Five publishers could suddenly expand sufficiently to prevent the anticipated competitive harm.

Two well-funded companies outside the Big Five highlighted by the defendants are Amazon and Disney. Amazon acquired several high-priced books when it first started its publishing business about a decade ago, but it has failed to make significant headway in the industry. *See* Trial Tr. at 172:17–25 (Pietsch). From 2019 to 2021, Amazon's share in acquiring the publishing rights to anticipated top-selling books declined from under [redacted] to under [redacted]. *See* PX 968 at 2. Amazon also struggles with selling its books outside of its own platform. *See* Trial Tr. at 171:17–23 (Pietsch). The Court therefore is not convinced that Amazon is a significant competitive constraint in the relevant market. The defendants argue that [redacted]. *See* Defs. PFOF ¶ 126. While Disney may have the motivation and financial resources to execute the alleged plan, it will still face many of the previously discussed barriers to entry. There is no evidence to suggest that Disney is better equipped than Amazon to succeed in the relevant market. In addition, it is a strain to characterize Disney's five-year aspirational plan as evidence of "timely" market entry. *See Staples II*, 190 F. Supp. 3d at 133 ("The relevant time frame for consideration in this forward looking exercise is two to three years.").

3. *Additional Arguments*

The defendants raise a medley of other arguments based on (1) the power of literary agents to constrain anticompetitive behavior by publishers; (2) efficiencies from the merger that will offset anticompetitive effects; (3) the lack of negative effects from the last major merger in the publishing industry; and (4) the parties' interest in finding the "best home" for S&S. The Court will consider each of these in turn.

i. Power of Agents

The defendants argue in post-trial briefing that the market-share data used by the government does not account for the control that agents wield over acquisition formats, which renders the data unreliable. *See* Defs. PCOL ¶¶ 71–73 ("Market concentration statistics also ignore the competitive effect of agents' control over the bargaining process."). To the contrary, the market-share data necessarily reflects agents' existing practices with respect to acquisition formats. The market-share numbers aggregate individual book deals, each of which was presumably subject to an acquisition format that was determined by an agent.

The defendants also have argued that agents can constrain the competitive harm of the merger through their control over acquisition formats. The defendants have suggested that even if some imprints are eliminated or consolidated after the merger, agents can readily find substitutes for the missing imprints in any given auction. *See* Trial Tr. at 3276:8–3277:21 (Defs. Closing) ("[T]here probably are hundreds, hundreds of these imprints spread around the various publishing houses. . . . [I]f the merger did functionally eliminate one potential participant, it will not necessarily change the dynamic of any given auction . . . because the agent can readily replace that publisher with another bidder."). Indeed, the defendants seem to treat agents as the buy-side analogue to "power buyers." "Courts have . . . noted that the existence of power buyers—sophisticated customers who retain strategies post-merger that may constrain the ability of the merging parties to raise prices — is a factor that can serve to rebut a prima facie case of anti-competitiveness." *Wilhelmsen*, 341 F. Supp. 3d at 70 (quotations omitted).

But agents cannot create competition where it does not exist, and competition is what ultimately increases authors' advances. *See* Trial Tr. at 114:25–115:6 (Pietsch), 596:5–597:4 (Karp), 251:4–251:20 (Pande). The proposed merger would reduce the number of imprints available to bid independently for any given book, so agents' ability to play prospective publishers against one another would weaken. *See* Merger Guidelines § 6.2 ("A merger between two competing [buyers] prevents [sellers] from playing those [buyers] off against each other in negotiations. This alone can significantly enhance the ability and incentive of the merged entity to obtain a result more favorable to it, and less favorable to the [seller], than the merging firms would have offered separately absent the merger.").

In any event, as a general matter, agents do not have the power to effectively discipline large publishers. Time after time, when agents have attempted to curb the Big Five's exercise of market power, the agents have failed. For example, agents were unsuccessful in attempts (1) to increase e-book royalties, *see* Trial Tr. at 2101:12–2105:5 (Wylie) (boycott of Wylie by Random House ended his attempt to secure higher e-book royalties for authors); (2) to unlink audio rights from publishing rights, PX 328 at 2–3 ("Remember when Amazon was offering seven figures on Audio before books were sold to publishers? We turned down big book after big book until agents realized we would not play in an auction without Audio. And now they always sell us Audio."); and (3) to prevent publishers from changing payment structures, *see* Trial Tr. at 1828:19–1829:18 (Walsh) (describing publishers' shift from paying out advances in halves to paying them out in quarters); PX 2008 (Fletcher) at 19–20 ([redacted] All those contract terms were important to authors and agents, but they were forced to back down in response to pressure from the Big Five.

ii. Efficiencies

The defendants argued at trial that efficiencies would limit the merger's anticipated competitive harm. Efficiencies alone might not suffice to rebut a prima facie case, but they "may nevertheless be relevant to the competitive effects analysis on the market required to determine whether the proposed transaction will substantially lessen competition." *Sysco*, 113 F. Supp. 3d at 82 (quotations omitted). The Court, however, precluded the defendants' evidence of efficiencies, after determining that the defendants had failed to verify the evidence, as required by law. *See* Trial Tr. at 2749:12–2772:24. Efficiencies therefore play no role in the instant analysis.

iii. The 2013 Penguin-Random House Merger

The defendants argue that the 2013 Penguin-Random House merger was a "natural experiment" that did not cause a decrease in advances paid for anticipated top-selling books. *See* Defs. PCOL ¶ 84 (quoting Merger Guidelines § 2.1.2); *see also* Defs. PFOF ¶ 226. They are correct that analogous historical events are useful for considering the likely effects of a merger. *See* Merger Guidelines § 2.1.2.

But the parties hotly dispute how the 2013 merger affected author advances. The defendants assert that advances for anticipated top-selling books did not decrease due to the merger, because they were already declining before the merger and continued to do so afterward. *See* Defs. PFOF ¶ 227; Trial Tr. at 2841:4–8 (Snyder), 2638:25–2639:14 (Snyder). The government counters that advances paid for anticipated top-selling books decreased more relative to other books' advances after the 2013 merger. *See* Govt. PFOF-PCOL ¶¶ 238–42; Trial Tr. at 3066:2–10 (Hill); PX 966. Ultimately, the Court finds the evidence about the 2013 merger inconclusive. The contraction in mass-market paperbacks around 2013 muddies the analysis, and the intervening nine years have brought important shifts in the industry, such as continued consolidation. *See* Trial Tr. at 169:2–170:20 (Pietsch). Thus, the aftermath of the 2013 merger does not affect the Court's analysis.

iv. A "Good Home" for S&S

Defendants have argued that PRH is the best home for the authors, editors, and staff of S&S. *See* Defs. PFOF ¶¶ 22–24. Witnesses have noted that S&S authors would gain many advantages from working with the combined entity, including access to PRH's distribution network. *See, e.g.*, Defs. PFOF ¶ 25 (PRH could bring its "industry-leading supply chain to bear on S&S's books, enabling S&S to obtain more retail shelf space, enjoy higher sales, and reach more readers." (citing Trial Tr. at 878:1–22 (Dohle))). Moreover, the defendants have suggested that if the sale to PRH is enjoined, Paramount Global might sell S&S to a private equity firm that would take on debt and "gut" the company. *See* Defs. PFOF ¶¶ 23–24; *see also* Trial Tr. at 2094:20–2095:2 (Wylie) ("So if it were, for instance, to go to private equity . . . , the private equity company wouldn't understand the business it was in; would, say, load it with debt as Blackstone did to Houghton Mifflin, basically destroying the publishing house so that it was sold at a discount later to one of the Big 5."), 1938:18–23 (Duhigg) ("And if [the merger] doesn't happen, it will be disastrous for Simon & Schuster, because they will get acquired by private equity . . . [a]nd they will gut that company.").

Those arguments are not relevant to the Court's analysis of the government's claim under the Clayton Act. The Court is required to assess the anticompetitive effects of the merger under the applicable statute and case law, which do not contemplate consideration of the preferences of the merging parties' employees and stakeholders, or their distaste for other potential buyers of the assets in question. The focus of the Court's inquiry is harm to competition in the relevant market. *See, e.g.*, *E. I. du Pont de Nemours*, 353 U.S. at 589, 592. Nevertheless, the Court notes that the expressed concerns about a private-equity acquisition are highly speculative. Other potential buyers from the publishing industry have shown interest in acquiring S&S, and it is just as likely that another publishing company will prevail in a future sale. *See* Trial Tr. at 2185:2–15 (Berkett). Nor is the Court moved by the desire of S&S and its employees to be acquired by PRH. It comes as no surprise that S&S would like to benefit from the extraordinary market power and other advantages that the combined entity would enjoy. The Court, however, must focus on harm to competition in the relevant market.

CONCLUSION

The government has presented a compelling case that predicts substantial harm to competition as a result of the proposed merger of PRH and S&S. It has properly defined a relevant market — focused on publishing rights for anticipated top-selling books — that encompasses 70 percent of the advances that publishers pay to authors. The post-merger concentration of the relevant market would be concerningly high: The merged entity would have a 49-percent market share, more than twice that of its closest competitor. Moreover, the top two competitors would hold 74 percent of the market; and the top four market participants would control 91 percent. The government has buttressed its market-share analysis with strong evidence of likely unilateral effects and coordinated effects that would hurt competition.

The defendants have failed to show that the relevant market is not well defined; have failed to establish that the market-share data inaccurately reflects market conditions; and have failed to rebut the government's affirmative evidence of anticompetitive harm. Contrary to the defendants' contentions, the relevant market appropriately identifies a submarket of targeted sellers — the authors of anticipated top-selling books. Those authors have unique needs and preferences, have fewer outlets that can satisfy their requirements, and therefore are vulnerable to anticompetitive behavior. The Court is unpersuaded by the defendants' arguments that the market-share data does not accurately reflect conditions in the relevant market because it does not account for constraints that would be imposed by existing and new competitors, literary agents, and internal imprint competition. Nor have the defendants presented admissible evidence of efficiencies or any other evidence that changes the Court's view of the competitive landscape.

Accordingly, the Court finds that the proposed merger of PRH and S&S violates Section 7 of the Clayton Act because it is likely to substantially lessen competition in the market for the publishing rights to anticipated top-selling books. The Court therefore will enjoin the merger. A separate order issued on October 31, 2022.

FLORENCE Y. PAN
United States Circuit Judge
(Sitting by designation in the United States
District Court for the District of Columbia)

Dated: November 14, 2022

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

UNITED STATES OF AMERICA, *Plaintiff*, **v.** **BERTELSMANN SE & CO. KGaA, PENGUIN RANDOM HOUSE, LLC, VIACOMCBS, INC., and SIMON & SCHUSTER, INC.,** *Defendants*.	**Civil Action No. 21-2886-FYP**

ORDER

This matter comes before the Court after a trial on the merits in the United States' suit to enjoin the merger of Penguin Random House, LLC, and Simon & Schuster, Inc., under Section 7 of the Clayton Act. *See* 15 U.S.C. § 18. Upon review of the extensive record and careful consideration of the parties' arguments, the Court finds that the United States has shown that "the effect of [the proposed merger] may be substantially to lessen competition" in the market for the U.S. publishing rights to anticipated top-selling books. *See id*. Accordingly, judgment shall be entered in favor of the Plaintiff and the merger shall be enjoined.

The Court's reasoning is set forth in the accompanying Memorandum Opinion, which is issued under seal because it contains "confidential information" and/or "highly confidential information," as defined in the Stipulated Protective Order, *see* ECF No. 38. The parties shall meet and confer and will jointly file proposed redactions to the Memorandum Opinion by

November 4, 2022. After considering the proposed redactions, the Court will issue a public version of the Memorandum Opinion.

Accordingly, it is hereby ordered that:

1. Defendants are hereby enjoined and restrained from consummating the proposed merger, or otherwise effecting a combination of Penguin Random House, LLC, and Simon & Schuster, Inc.; and it is further ordered that
2. Defendants shall take any and all necessary steps to prevent any of their officers, directors, domestic or foreign agents, divisions, subsidiaries, affiliates, partnerships, or joint ventures from consummating, directly or indirectly, any such merger, or otherwise effecting any combination of Penguin Random House, LLC, and Simon & Schuster, Inc.
3. On or before November 4, 2022, the parties shall meet and confer and jointly file proposed redactions of "confidential information" and "highly confidential information" as defined in the Stipulated Protective Order.

SO ORDERED.

FLORENCE Y. PAN
United States Circuit Judge
(Sitting by designation in the United States
District Court for the District of Columbia)

Dated: October 31, 2022

BERTELSMANN

PRESS RELEASE

Bertelsmann Plans to Appeal Court Ruling on Penguin Random House, Simon & Schuster Merger

- **Merger would be in good for competition**
- **Court's decision is based on incorrect basic assumptions**

Gütersloh / Washington, November, 1, 2022 – Bertelsmann acknowledges the ruling by the U.S. District Court in Washington, D.C., prohibiting the planned merger of Penguin Random House and Simon & Schuster. The international media, services, and education company believes the district court's decision is wrong and plans to file an expedited appeal against the ruling. The shareholders of Penguin Random House and Simon & Schuster, Bertelsmann and Viacom CBS, Inc. (now Paramount Global), had announced plans to combine their global book businesses in November 2020. While Britain's Competition & Markets Authority (CMA) already approved the transaction in May 2021, the U.S. Department of Justice (DoJ) had filed a lawsuit against the planned merger in November 2021, which the court has now upheld.

Thomas Rabe, CEO of Bertelsmann, said: "We do not share the court's assessment any more than we previously shared the Department of Justice's position. Both are based on incorrect basic assumptions, including an inaccurate definition of the market. A merger would be good for competition. We remain convinced that Bertelsmann and Penguin Random House would be the best creative home for Simon & Schuster - with a wide variety of publishers that could operate independently under one umbrella. We will be filing a motion to appeal with the D.C. Court of Appeals."

About Bertelsmann
Bertelsmann is a media, services and education company that operates in about 50 countries around the world. It includes the entertainment group RTL Group, the trade book publisher Penguin Random House, the music company BMG, the service provider Arvato, the Bertelsmann Printing Group, the Bertelsmann Education Group and Bertelsmann Investments, an international network of funds. The company has 145,000 employees and generated revenues of €18.7 billion in the 2021 financial year. Bertelsmann stands for creativity and entrepreneurship. This combination promotes first-class media content and innovative service solutions that inspire customers around the world. Bertelsmann aspires to achieve climate neutrality by 2030.

Bertelsmann online

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BERTELSMANN

PRESS RELEASE

Bertelsmann Will Drive Growth of Penguin Random House Without Simon & Schuster

- **Book business to grow organically and through acquisitions**
- **Substantial investment funds for the Boost strategy**

Gütersloh / New York Nov 21, 2022 – Bertelsmann will advance the growth of its global book publishing business without the previously planned merger of Penguin Random House and Simon & Schuster. As part of the international media, services and education group's global content strategy, Penguin Random House, too, will grow significantly in the years ahead, both organically and through acquisitions. The proposed merger of the two book publishing groups was blocked by the U.S. District Court in Washington, D.C., a few weeks ago. Following discussions with Simon & Schuster shareholder Paramount Global, Bertelsmann will not pursue its original plan of appealing against the ruling.

Thomas Rabe, Chairman & CEO of Bertelsmann, commented: "The book business has been part of Bertelsmann's identity for 187 years, and this will not change: Penguin Random House is part of the Global Content Strategy, one of our five strategic priorities. Bertelsmann plans to achieve annual growth of five to ten percent in this area – organically, but also through acquisitions. In total, Bertelsmann will invest between five and seven billion euros in the growth of its businesses in the years ahead as part of its Boost Plan. Significant investment funds will be available to Penguin Random House as well."

Penguin Random House last generated record revenues of €4 billion in fiscal year 2021. The global book publishing group employs some 10,000 people. Its 300 book publishing companies in 20 countries release around 16,000 new titles every year. The group sells more than 700 million books a year. In November 2020, Bertelsmann and Paramount Global (then Viacom CBS) had announced plans to combine their global book businesses. While the U.K. Competition & Markets Authority (CMA) had already approved the transaction in May 2021, the U.S. Department of Justice (DoJ) filed a lawsuit against the proposed merger in November 2021. This action was upheld by the U.S. District Court in Washington D.C. on October 31, 2022.

About Bertelsmann

Bertelsmann is a media, services and education company that operates in about 50 countries around the world. It includes the entertainment group RTL Group, the trade book publisher Penguin Random House, the music company BMG, the service provider Arvato, the Bertelsmann Printing Group, the Bertelsmann Education Group and Bertelsmann Investments, an international network of funds. The company has 145,000 employees and generated revenues of €18.7 billion in the 2021 financial year. Bertelsmann stands for creativity and entrepreneurship. This combination promotes first-class media content and innovative service solutions that inspire customers around the world. Bertelsmann aspires to achieve climate neutrality by 2030.

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Power Buyers Defense

FTC v. WILH. WILHELMSEN HOLDING ASA
341 F. SUPP. 3D 27, 70-71 (D.D.C. 2018)
(excerpt[1])

TANYA S. CHUTKAN, District Judge

The Federal Trade Commission ("FTC") has moved for a preliminary injunction to block a proposed merger between defendants Wilhelmsen Maritime Services AS ("WMS"), Wilhelmsen Ship Services ("WSS") (collectively "Wilhelmsen"), and The Resolute Fund II, L.P., Drew Marine Intermediate II B.V., and Drew Marine Group, Inc. (collectively "Drew"), two large providers of marine water treatment chemicals and related services. The FTC objects to the merger on the grounds that Defendants are each other's closest and only realistic competition for supplying these chemicals and services on a global scale, and the merger threatens to reduce or eliminate tangible consumer benefits resulting from market competition. Having considered the evidence presented through live testimony, as well as extensive pleadings, exhibits, and other submissions, the court hereby GRANTS the motion for preliminary injunction.

[The court found, for the purpose of deciding whether to enter a preliminary injunction, that the supply of marine water treatment (MWT) products and services, including boiler water treatment (BWT) chemicals, cooling water treatment (CWT) chemicals, and associated products and services, to global fleets, constituted a relevant antitrust market and that, within this market, the FTC had established a prima facie case of anticompetitive effect. In response, the merging parties advanced entry, power buyer, and efficiencies defenses.]

. . .

b. *Power Buyers*

1. LEGAL STANDARD

Courts have also noted that the existence of power buyers—sophisticated customers who retain strategies post-merger that "may constrain the ability of the merging parties to raise prices," Merger Guidelines § 8—is a factor that can serve to "rebut a prima facie case of anti-competitiveness." *Cardinal Health*, 12 F.Supp.2d at 59. However, "[t]he ability of large buyers to keep prices down ... depends on the alternatives these large buyers have available to them." *Sysco*, 113 F.Supp.3d at 48. Where mergers reduce alternatives—i.e., prevent the use of certain competitive strategies—"the power buyers' ability to constrain price and avoid price discrimination can be correspondingly diminished." *Id*. (citing Merger Guidelines § 8). Thus, the mere presence of power buyers "does not necessarily mean that a merger will not result in anti-competitive effects." *Cardinal Health*, 12 F.Supp.2d at 59. In assessing a power

1. Record citations omitted

buyer argument, the court should "examine the choices available to powerful buyers and how those choices likely would change due to the merger," keeping in mind that "[n]ormally, a merger that eliminates a supplier whose presence contributed significantly to a buyer's negotiating leverage will harm that buyer." Merger Guidelines § 8. Finally, although the consideration of non-entry factors—including the existence of power buyers—is "relevant, and can even be dispositive, in a section 7 rebuttal analysis," *Baker Hughes*, 908 F.2d at 987, courts have not typically held "that power buyers alone enable a defendant to overcome the government's presumption of anticompetitiveness." *Cardinal Health,* 12 F.Supp.2d at 58; *Chicago Bridge & Iron Co. N.V. v. FTC*, 534 F.3d 410, 440 (5th Cir. 2008) ("[C]ourts have not considered the 'sophisticated customer' defense as itself independently adequate to rebut a prima facie case.").

2. ANALYSIS

Defendants argue that the FTC's Global Fleets construct focuses on the largest shipping companies—those most likely to have the power to constrain the merger's anticompetitive effects. In support of this contention, Defendants point out that customers tend to purchase other goods from suppliers, which permits them to discipline attempted BWT [boiler water treatment chemicals] and CWT [cooling water treatment chemicals] price increases by switching or credibly threatening to switch purchases of these other products to other suppliers or by negotiating price decreases on other products. Defendants further argue that customers could adapt purchases to another supplier's distribution network or shift part of their fleet to another competitor, since many vessels in Global Fleets do not avail themselves of all of Defendants' networks—instead visiting a subset of available ports and picking up MWT from an even smaller subset. Defendants also contend that Global Fleets could stockpile larger quantities of MWT products in order to shift purchases to major ports with lower costs, and that customers can partner with suppliers to sponsor entry or expansion to new ports.

The court is unpersuaded by Defendants' power buyer argument. The evidence is mixed—at best—regarding the effectiveness of each of the Defendants' suggested strategies. Although at least one witness suggested that customers could shift purchases of other products in more competitive markets to other suppliers, there is, as Dr. [Avid] Nevo [the FTC's expert economist] noted, little empirical basis for the notion that this strategy—already available to large customers—would yield any additional benefits beyond those customers currently enjoy. Similarly, while testimony suggested that customers may be able to stockpile product and concentrate purchases in ports where products are cheaper, that same testimony suggests that storage space is often limited and that customers already do so. Defendants have not identified any new strategy or alternative likely to emerge post-merger—instead, they have focused on strategies that are already part of the competitive landscape and which show no promise of becoming more effective. On the other hand, the FTC has shown that the merger will result in the loss of a proven strategy—the ability to leverage one large, global supplier against another—that appears to be the most effective price constraint in the consolidated MWT market. In other words, the FTC has established a reasonable probability that as a result of the merger, sophisticated buyers will have one less alternative strategy through which they can exercise power, and Defendants have not identified any equally or more effective buyer options to counteract that loss. Thus, the reduction of buyer alternatives means that "power buyers' ability to constrain price and avoid price discrimination can be correspondingly diminished," *Sysco*, 113 F.Supp.3d at 48, and evidence of buyer power is insufficient to rebut the FTC's prima facie case.

A NOTE ON THE POWER BUYERS DEFENSE

In some markets, large buyers may exist that, because of their bargaining power, are able to protect themselves from the anticompetitive effects that otherwise would result from a merger. These buyers, for example, may be a disruptive force that precludes effective coordinated interaction among incumbent upstream firms or they may have sufficient bargaining power to block the unilateral exercise of market power by the combined firm.

The courts and the merger guidelines recognize that the bargaining power or firms can play a significant role in assessing the competitive effects of a merger and may act, either alone or in conjunction with other defenses, to rebut a prima facie case of anticompetitive effect.[1] While in a particular case a power buyer defense may not be sufficient to rebut the prima facie case, that defense in conjunction with other defenses may be sufficient.[2]

Simply because a buyer is powerful does not mean that it is able to discipline the collective or unilateral exercise of market power by suppliers postmerger to protect itself.[3] The question here is two-fold: can the putative power buyer protect itself at all, and, if so, can it protect itself sufficiently to completely eliminate the anticompetitive effect of the merger on it?[4] Moreover, even a particular buyer can protect itself from the exercise of market power, its action may not protect other, less powerful buyers and only result in a regime of price discrimination where some buyers get hurt and

1. *See* Chicago Bridge & Iron Co. N.V. v. FTC, 534 F.3d 410, 440 (5th Cir. 2008); FTC v. Wilh. Wilhelmsen Holding ASA, 341 F. Supp. 3d 27, 70 (D.D.C. 2018); FTC v. Cardinal Health, Inc., 12 F. Supp. 2d 34, 58 (D.D.C. 1998); U.S. Dep't of Justice & Fed. Trade Comm'n, DOJ/FTC Horizontal Merger Guidelines § 8 (rev. 2010).

2. *See, e.g.*, United States v. Baker Hughes, 908 F.2d 981 (D.C.Cir.1990) (finding the existence of power buyers along with the ease of entry was sufficient to rebut a prima facie case of anticompetitive effect); United States v. Country Lake Foods, Inc., 754 F. Supp. 669, 675, 679 (D. Minn. 1990) (finding the lack of entry barriers, the potential entry by distant dairies, the power of the fluid milk buyers in the area, the possibility of vertical integration, and efficiencies rebutted a prima facie case of anticompetitive effect).

3. *See, e.g.*, *Wilhelmsen*, 341 F. Supp. 3d at 70; FTC v. Cardinal Health, Inc., 12 F. Supp. 2d 34, 58 (D.D.C. 1998).

4. *See Wilhelmsen*, 341 F. Supp. 3d at 70.

others do not.[5] The 2010 Merger Guidelines recognize the defense and these limiting principles:

> The Agencies consider the possibility that powerful buyers may constrain the ability of the merging parties to raise prices . . . . However, the Agencies do not presume that the presence of powerful buyers alone forestalls adverse competitive effects flowing from the merger. Even buyers that can negotiate favorable terms may be harmed by an increase in market power. The Agencies examine the choices available to powerful buyers and how those choices likely would change due to the merger. Normally, a merger that eliminates a supplier whose presence contributed significantly to a buyer's negotiating leverage will harm that buyer.... Furthermore, even if some powerful buyers could protect themselves, the Agencies also consider whether market power can be exercised against other buyers.[6]

It is important in raising a power buyer defense to present both an explanation and evidence of the mechanics of how the power buyer will constrain the exercise of market power postmerger against itself and how other customers, if any, in the market will be protected.

Self-protection. The first requirement for a power buyer defense is that the putative power buyer be able to protect itself from any anticompetitive effect resulting from the merger. In the absence of a clear mechanism—and the incentive to use it—courts and the enforcement agencies will reject a power buyer defense.[7]

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5. *See* FTC Cardinal Health, Inc., 12 F. Supp. 2d 34, 61 (D.D.C. 1998) (rejecting power buyer defense in a two mergers of mergers of wholesale prescription drug distributors where, although large pharmacy chains had significant bargaining power and likely could protect themselves, the market also contained independent pharmacies and the smaller hospitals that could not protect themselves); United States v. United Tote, 768 F. Supp. 1064, 1085 (D. Del.1991) ("Even if the Court were to accept United Tote's argument that the owners of these large, sophisticated facilities would be able to protect themselves from any anti-competitive price increase, this would still leave at least one hundred nine facilities unprotected in the small market segment alone.").

6. U.S. Dep't of Justice & Fed. Trade Comm'n, DOJ/FTC Horizontal Merger Guidelines § 8 (rev. 2010). For cases recognizing the existence of the defense and applying Section 8 of the guidelines, see FTC v. RAG-Stiftung, 436 F. Supp. 3d 278, 315 (D.D.C. 2020); FTC v. v. Wilh. Wilhelmsen Holding ASA, 341 F. Supp. 3d 27, 70 (D.D.C. 2018); FTC v. Sanford Health, Sanford Bismarck, No. 1:17-CV-133, 2017 WL 10810016, at *16 (D.N.D. Dec. 15, 2017), *aff'd*, 926 F.3d 959 (8th Cir. 2019); United States v. Anthem, Inc., 236 F. Supp. 3d 171, 221 (D.D.C. 2017); FTC v. Sysco Corp., 113 F. Supp. 3d 1, 48 (D.D.C. 2015).

7. *See* Chicago Bridge & Iron Co. v. FTC, 534 F.3d 410, 439-40 (5th Cir. 2008) (discussing types of power buyer defense mechanisms); AlliedSignal, Inc. v. B.F. Goodrich Co., 183 F.3d 568, 575 (7th Cir. 1999); FTC v. Cardinal Health, Inc., 12 F. Supp. 2d 34, 58 (D.D.C. 1998); but cf. FTC v. RAG-Stiftung, 436 F. Supp. 3d 278, 315, 317 (D.D.C. 2020) (denying a preliminary injunction where, among other factors, "the hydrogen peroxide industry is marked by sophisticated and powerful customers that are well equipped to defeat coordination" and "there is no reason to suspect that suppliers will not continue to participate in a blind bidding system for long-term and large contracts to win the business of sophisticated buyers" but not further explaining the mechanism).

The courts have identified three self-protection mechanisms to prevent the exercise of market power against the putative power buyer, although proving these mechanisms actually operate in a particular case has been problematic:

1. *Share shifting*. When buyers are large relative to the overall market, upstream firms have substantial excess capacity to service new business, marginal costs are low relative to fixed costs, and the costs to the buyers of switching from one supplier to another are low, then price competition for the patronage of these buyers usually is intensive even when the market is highly concentrated. In these circumstances, the upstream firms already have covered their fixed costs, so that—in light of the relatively low marginal costs—the revenues earned on incremental business are almost all profit. Conversely, the loss of one of these buyers to another firm will cost the original supplier heavily, since almost all of the lost revenue is lost profit. As a result, under this theory changes in concentration short of a merger to monopoly are unlikely to disturb price competition in such markets, at least in the absence of explicit collusion.[8] Courts can be skeptical, however, and find that the bargaining power of the putative power buyers declines as the number of the firms with the excess capacity are few in number and become fewer as a result of the merger.[9]

2. *Sponsoring entry*. In markets in which the primary impediment to entry is the risk of not being able to secure enough business to load a minimum efficient scale plant, buyers (who may at collectively though a buying group) that are large relative to the market can protect themselves, at least in the long-run, by inducing entry by third parties by agreeing to purchase enough output to load the new plant. When the time to enter is short and the sunk costs are low, the threat of inducing entry is likely to be a credible one and the threat alone may be sufficient to dissuade the merged firm to raising prices to these buyers. In

8. For cases recognizing a share-shifting argument, see, for example, FTC v. Tenet Health Care Corp., 186 F.3d 1045, 1055 (8th Cir. 1999); *Wilhelmsen*, 341 F. Supp. 3d at 70-71; and presumably FTC v. RAG-Stiftung, 436 F. Supp. 3d 278, 317 (D.D.C. 2020).

9. *See* United States v. Anthem, Inc., 236 F. Supp. 3d 171, 221 (D.D.C. 2017) (rejecting defense where, notwithstanding the substantial sophisticated of large national companies, the "loss of one competitor from the four major carriers alters the RFP and negotiating dynamic, even with strong advocates on the other side" and "[t]his loss of leverage undermines the defense contention that customers will be able to wield their seasoned human resource managers and consultants to counteract the anticompetitive effects of the merger"); *see also* Chicago Bridge & Iron Co. v. FTC, 534 F.3d 410, 440 (5th Cir. 2008) (rejecting share-shifting as defense where the market has had only two dominant players, PDM and CB&I [the merging companies], so buyers cannot now swing back and forth between competitors to lower bids post-acquisition); FTC v. Sysco Corp., 113 F. Supp. 3d 1, 48 (D.D.C. 2015) (finding that large customers premerger have been able "to keep prices down by leveraging the defendant companies against one another," the merger will eliminate that ability); U.S. Dep't of Justice & Fed. Trade Comm'n, Horizontal Merger Guidelines § 8 (rev. 2010) ("Normally, a merger that eliminates a supplier whose presence contributed significantly to a buyer's negotiating leverage will harm that buyer.")

such situations, markets are likely to remain competitive even with significant increases in concentration in upstream markets caused by mergers.[10]

3. *Vertical integration*. Vertical integration is a special case of inducing entry. Here, rather than inducing a third party to enter the upstream market, the downstream buyers (who again may act collectively) may vertically integrate into the upstream market of the merged firm. Essentially the same conditions apply for the defense as for inducing entry.[11]

Even when there is an arguable mechanism, the defense is likely to fail for lack of sufficient evidence if (1) the putative buyer does not support the defense, or (2) there is evidence of historical episodes where the putative power buyer (or a similarly situated firm) has not been able to prevent a merged firm from raising prices to it.[12] This was the situation in *Sanford Heath*, where (1) a representative from blue Cross (the putative power buyer) testified that that postmerger Sanford Heath would be able to force Blue Cross to choose between paying a higher price or exiting the market, and (2) there was evidence that Blue Cross in the past had been forced to pay higher prices to a near-monopolist in another part of North Dakota.

Protection of others. Whenever a power buyer defense is employed, the parties should pay careful attention to the possibility that, although the large firms in the market may be able to protect themselves, the smaller ones may not. The enforcement agencies and the courts will examine closely the possibility that the upstream firms can isolate the smaller firms and discriminate against them while acting competitively toward the larger firms. If some buyers are able to protect themselves from the

10. *See* Chicago Bridge & Iron Co. v. FTC, 534 F.3d 410, 440 (5th Cir. 2008) (rejecting sponsored entry where "[n]o buyer can assure that a new entrant has 'adequate volume and returns' for meaningful entry into the market); FTC v. Cardinal Health, Inc., 12 F. Supp. 2d 34, 59 (D.D.C. 1998) (finding large pharmacy chains have ability to sponsor entry into drug wholesale distribution to protect themselves but rejecting power buyer defense because of unprotected smaller pharmacies and hospitals); United States v. Baker Hughes Inc., 731 F. Supp. 3, 11 (D.D.C.) (finding the "sophistication" of large customers significant in being able to deter price increases, presumably although not explicitly because they could induce entry by Canadian suppliers) , *aff'd*, 908 F.2d 981, 986 (D.C. Cir. 1990); *see also* FTC v. Sanford Health, Sanford Bismarck, No. 1:17-CV-133, 2017 WL 10810016, at *29 (D.N.D. Dec. 15, 2017) (recognizing mechanism but finding it unsupported by the record), *aff'd*, 926 F.3d 959 (8th Cir. 2019).

11. *See* United States v. Country Lake Foods, Inc., 754 F. Supp. 669, 674, 675, 679 (D. Minn. 1990) (finding capability to vertically integrate); *see also* Sanford Health, 2017 WL 10810016, at *29 (recognizing mechanism but finding it unsupported by the record); United States v. Energy Sols., Inc., 265 F. Supp. 3d 415, 442 (D. Del. 2017) (same).

12. *See Chicago Bridge*, 534 F.3d at 440 (rejecting defense where premerger "[i]nstances of CB&I pressuring customers to offer sole-source contracts by withdrawing its bid and CB&I's success at obtaining sole-source contracts undermine any argument that buyers have the ability to pressure CB&I in contract negotiations").

otherwise anticompetitive effects of a merger but others are not, the defense will fail.[13] This was the case, for example, in *Sanford Health*, where although Blue Cross was a very large firm with a statewide share of the commercial health insurance market of between 55% and 65%, that still left between 35% and 45% of the commercial insurers unprotected from the merger.[14]

Acceptance by courts. To date, courts have been very reluctant to find existence of "power buyers" sufficient by itself to rebut a *prima facie* case of anticompetitive effect,[15] but several courts have noted "power buyers" as one of several factors in a successful rebuttal.[16] The DOJ and FTC are probably more willing to accept the defense, but they will be demanding both in the articulation of precisely why the defense should apply in the case, in the evidence from the customers who are said to be able to exercise this power, and in the ability of all firms in the market to protect themselves.

13. *See* FTC v. Cardinal Health, Inc., 12 F. Supp. 2d 34, 59 (D.D.C. 1998); FTC v. Tenet Healthcare Corp., 17 F. Supp. 2d 937, 941 (E.D. Mo. 1998), *rev'd on other grounds*, 186 F.3d 1045 (8th Cir. 1999); United States v. United Tote, Inc., 768 F. Supp. 1064, 1085 (D. Del. 1991).

14. FTC v. Sanford Health, Sanford Bismarck, No. 1:17-CV-133, 2017 WL 10810016, at *16 (D.N.D. Dec. 15, 2017), *aff'd*, 926 F.3d 959 (8th Cir. 2019).

15. A counterexample may be United States v. Country Lake Foods, Inc., 754 F. Supp. 669, 679 (D. Minn. 1990), where the court denied the government's motion for a preliminary injunction where 90 percent of the market consisted of large customers able to protect themselves individually and that smaller customer could unite through a buying group to protect themselves.

16. *See, e.g.*, United States v. Baker Hughes Inc., 908 F.2d 981, 98687 (D.C. Cir. 1990); United States v. Archer-Daniels-Midland Co., 781 F. Supp. 1400, 1422 (S.D. Iowa 1991) (accepting a power buyers defense where the market for high fructose corn syrup "is populated by very large and sophisticated purchasers and there is a continuing trend toward increasing concentration on the buying side, as large bottlers purchase formerly independent bottling franchises or bring them under their sweetener purchasing wings, and as smaller concerns band together in buying cooperatives to increase their purchasing leverage"). For a case in which the defense was rejected as insufficient on the merits, see FTC v. Cardinal Health, Inc., 12 F. Supp. 2d 34, 5861 (D.D.C. 1998).

Failing Firm Defense

UNITED STATES V. ENERGY SOLUTIONS, INC.
265 F. Supp. 3d 415, 444 (D. Del. 2017)
(excerpt[1])

[SUE L.] ROBINSON, Senior District Judge

I. INTRODUCTION

The Department of Justice, Antitrust Division (the "government"), seeks to enjoin Rockwell Holdco, Inc. and its wholly owned subsidiary Energy Solutions, Inc. ("Energy Solutions") from acquiring Andrews County Holding, Inc. and its wholly owned subsidiary Waste Control Specialists LLC ("WCS," and collectively with the other defendants, the "defendants"). The government alleges that the acquisition would substantially lessen competition for disposal of low-level radioactive waste in violation of Section 7 of the Clayton Act, 15 U.S.C. § 18.

. . .

II. FINDINGS OF FACT

. . .

E. WCS Financial Situation

WCS has asserted a failing firm defense. The record shows that so far, WCS has not been a profitable enterprise. Because of regulatory requirements, WCS operates with high fixed costs. Meanwhile, the volume of LLRW generated over the past decade has declined. Lower disposal volumes means less coverage for WCS's fixed costs. As a result, WCS has never made an operating profit and consistently misses projections. Even US Ecology has suggested that the amount of Class B/C waste generated annually after the industry became "highly motivated to reduce volumes ... isn't enough to make WCS viable."

The government put forth several facts to rebut defendants' assertion that WCS is at risk of imminent failure. WCS funds its operations through an $85 million revolving credit facility with its parent Valhi. Valhi extended WCS's credit facility until March 31, 2018. As of the end of 2016, WCS had an outstanding balance on that credit facility of $41.7 million. Valhi projects that WCS will borrow an additional [redacted] between the beginning of 2017 and the end of the first quarter 2018, when the current credit facility expires, but the total amount borrowed will still be "below the maximum available."

The government further notes that WCS is a relatively new firm (opened in 2012) still trying to win customers who are under long-term LOP agreements with Energy Solutions. WCS has never defaulted on any debt. It is still current on its lease payments

1. Record citations and footnotes omitted.

and trust fund payments. It is meeting payroll and paying bonuses. And WCS recently executed several long-term disposal contracts. It has also invested in future growth opportunities, including teaming agreements with North Star for decommissioning projects and an application with the NRC seeking approval to construct and operate a consolidated interim storage facility ("CISF") for spent nuclear fuel. The decommissioning market is expected to grow substantially over the next twenty years, as aging nuclear power plants close, and could reach $53 billion or more. Approximately 10% of the cost of decommissioning goes towards LLRW disposal.

In the CISF application filed in April 2016, WCS represented that its "financial qualifications are adequate to carry out the activities for which the license is sought.") WCS has filed a number of updates to the application and never changed the representation regarding its financial qualifications. Also in March 2017, WCS's independent auditor did not issue a going concern qualification, meaning that the auditors believe WCS will be in business twelve months from the date of the report. Finally, WCS has not entered into preliminary discussions with its regulator, the Texas Commission on Environmental Quality ("TCEQ"), about closing the WCS facility, even though it cannot take the first step in that process–i.e., developing a contingency plan for closing–until it consults with the TCEQ.

WCS tries to rebut the government's picture of its financial health by pointing to several investments in growth opportunities that have not (yet?) proved profitable, including cask rentals, partnerships with processors to offer sorting and segregation, and teaming agreements for bids on decommissioning projects. Opening the exempt cell was a growth initiative but, according to WCS's chief financial officer, "[r]unning [the exempt cell] full out . . . could never generate enough income to make up the delta on the loss." WCS's CEO agrees that decommissioning projects are "good jobs," but says they are "not a silver bullet for the financial issues of WCS." WCS needs "near-term cash to survive" and the "decommissioning projects are too far out to save us." Several witnesses testified that it is difficult to accurately forecast when exactly disposal companies will start to see revenues from decommissioning projects, because those projects are famous for "sliding right on the schedule." In addition, WCS has "temporarily suspend[ed]" its CISF application "due to substantially increased" costs to have the application reviewed at a time when it "must focus its limited financial resources on those expenditures necessary to safely run and maintain its current facilities." Valhi has also suspended charges to WCS under their intercorporate services agreement, whereby WCS is supposed to pay for services Valhi employees provide to WCS, including accounting, human resources, legal, tax, risk management, and executive management.

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III. CONCLUSIONS OF LAW

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C. Rebuttal

Once the government establishes a prima facie case, the defendant must "show that the market-share statistics [give] an inaccurate account of the acquisitions' probable effects on competition." *United States v. Citizens & S. Nat'l Bank*, 422 U.S. 86, 120 (1975). Before trial, defendants asserted that the following factors would rebut the government's prima facie case: (1) customers' ability to substitute defendants' services with self-help; (2) the existence of powerful buyers; (3) the existence of regulatory schemes that constrain anticompetitive effects; (4) efficiencies to be gained from the merger; (5) the weakened competitor doctrine; (6) the ease of entry and expansion into the market; and (7) the failing firm defense.

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2. Failing firm defense

The failing-firm doctrine applies a "choice of evils" approach where "the possible threat to competition resulting from an acquisition is deemed preferable to the adverse impact on competition and other losses if the company goes out of business." *Gen. Dynamics*, 415 U.S. at 507; *Mich. Citizens for an Independent Press v. Thornburgh*, 868 F.2d 1285, 1288 (D.C. Cir. 1989). To successfully assert the defense, defendants have the burden of showing "(1) that the resources of [WCS] were 'so depleted and the prospect of rehabilitation so remote that it faced the grave probability of a business failure,' and (2) that there was no other prospective purchaser for it." *United States v. Greater Buffalo Press, Inc*., 402 U.S. 549, 555 (1971). Because the doctrine is "narrow in scope," *Citizen Pub. Co. v. United States*, 394 U.S. 131, 139 (1969), it "rarely succeeds," Philip E. Areeda & Herbert Hovenkamp, Antitrust Law ¶ 951e (4th ed. 2016).

The parties contest whether WCS is in imminent failure. There is evidence to support both sides of the issue.20 Ultimately, however, the court need not decide that issue, because defendants have failed to demonstrate that Energy Solutions is the "only available purchaser." "The failing company doctrine plainly cannot be applied in a merger or in any other case unless it is established that the company that acquires the failing company or brings it under dominion is the only available purchaser." *Citizen Pub.*, 394 U.S. at 138. For Energy Solutions to be the only available purchaser, defendants must show that WCS made "good faith efforts to elicit reasonable alternative offers ... that would both keep it in the market and pose a less severe danger to competition." *Dr. Pepper/Seven–Up Co. v. Fed. Trade Comm'n*, 991 F.2d 859, 865 (D.C. Cir. 1993); *Joseph Ciccone & Sons, Inc. v. E. Indus., Inc*., 537 F. Supp. 623, 628 (E.D. Pa. 1982) ("Successful invocation of that doctrine requires proof that the defendant acquired the failing company . . . by way of a 'reasonable offer which effects the least anti-competitive result.'").

Defendants have not shown that WCS's parent, Valhi, made a good faith effort as part of its 2015 sale process to elicit reasonable alternative offers. Valhi engaged with one other potential bidder–[redacted]–and left it in the dark about the sale process before abruptly ending discussions without obtaining a bid. Thus, Valhi essentially engaged in a single bidder process and then agreed to several deal protection devices that have made it impossible to entertain other offers once it became known that Valhi was finally serious about selling all of WCS. Delaware courts have found that a no-talk provision without a fiduciary-out, as existed here, "is the legal equivalent of willful blindness" that may prevent a board from meeting its duty to "be informed of all material information reasonably available," which would include reasonable alternative offers. *Phelps Dodge Corp. v. Cyprus Amax Minerals Co.*, 1999 WL 1054255, at *1–2 (Del. Ch. Sept. 27, 1999); *compare In re IXC Commc'ns, Inc. v. Cincinnati Bell, Inc.*, 1999 WL 1009174, at *6 (Del. Ch. Oct. 27, 1999) (finding that a board with a no-talk and no-shop provision adequately informed itself of reasonable alternatives by publicly announcing 6 months before the merger that it had retained an investment banker to consider possible merger or sale options and obtaining a fiduciary-out that allowed it to entertain superior proposals).

WCS argues that it has always had a "for sale" sign hanging out such that if there were another interested party, it would have appeared by now. But the facts suggest otherwise. It was well known in the industry that Energy Solutions made frequent overtures, or "annual calls," to buy WCS and had been repeatedly rebuffed. In addition, the deal on which Valhi focused in 2014 was for a minority equity investment, not a sale of the entire company. There was no clear "for sale" sign until WCS announced its transaction with Energy Solutions and, then, Valhi could neither respond nor share information that would allow another interested party to formulate a credible bid, let alone a bid that provides the "least anti-competitive result." *Joseph Ciccone & Sons*, 537 F. Supp. at 628. Considering the foregoing, the court does not give any weight to the fact that no other company but Energy Solutions has made a firm offer.

Finally, under the horizontal merger guidelines, a reasonable alternative offer is "[a]ny offer to purchase the assets of the failing firm for a price above the liquidation value of those assets." Horizontal Merger Guidelines (2010) § 11 n. 6. Valhi was clearly focused on obtaining what it perceived to be WCS's fair value, not an offer above the liquidation value, which is likely to be less. The court is sympathetic to the fact that if Valhi genuinely wants to exit the LLRW disposal market, there may be few (if any) potential buyers that would not raise some anti-trust concerns. The parties did not address whether the law gives Valhi the ability to sell WCS without it being a failing firm. Nevertheless, under the facts presented here, defendants have not shown that Valhi/WCS made good faith efforts to elicit reasonable alternative offers that would pose a less severe danger to competition.

A NOTE ON THE FAILING FIRM DEFENSE

In 1930, the Supreme Court, in International Shoe Co. v. FTC,[1] held that when the acquired company's resources were depleted, business failure was a grave possibility, and no noncompetitor was willing to purchase the failing firm, an acquisition by a competitor that otherwise might threaten competition would not violate the Clayton Act.[2] The legislative history of the 1950 amendments to the Clayton Act specifically

1 International Shoe Co. v. FTC, 280 U.S. 291 (1930).

2 *See* United States v. General Dynamics Corp., 415 U.S. 486 (1974); Citizen Publ'g Co. v. United States, 394 U.S. 131, 137-38 (1969).

recognized this "failing company" defense.[3] In *General Dynamics*, the Supreme Court characterized the defense as a "lesser of two evils" approach, in which the possible threat to competition resulting from the acquisition was preferable to the adverse competitive impact and other losses that would be incurred if the failing company failed.[4]

The failing company defense is frequently invoked in transactions that are *prima facie* unlawful under the *Philadelphia National Bank* presumption. It has been invoked on numerous occasions in the courts, usually without success.[5] Likewise, although the 2010 DOJ/FTC Horizontal Merger Guidelines acknowledge that the failing company doctrine is at least a factor in the competitive analysis, if not a standalone defense, the Guidelines employ the doctrine restrictively.

Judicial approach

The traditional judicial formulation of the failing company defense is straightforward: (1) the acquired firm must be failing or its failure must be imminent; and (2) there must be no alternate purchasers whose acquisition of the acquired firm would be less anticompetitive than the one proposed.[6] Some courts have added a third requirement: a reorganization of the acquired firm into a viable economic enterprise is

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3 S. REP. NO. 1775, 81st Cong., 2d Sess. 7 (1950); H.R. REP. NO. 1191, 81st Cong., 1st Sess. 6 (1949).

4 United States v. General Dynamics Corp., 415 U.S. 486, 507 (1974).

5 The successful cases include International Shoe Co. v. FTC, 280 U.S. 291 (1930); Union Leader Corp. v. Newspapers of New England, Inc., 284 F.2d 582 (1st Cir. 1960); Reilly v. Hearst Corp., 107 F. Supp. 2d 1192, 120305 (N.D. Cal. 2000); FTC v. Great Lakes Chem. Corp., 528 F. Supp. 84, 96-98 (N.D. Ill. 1981); United States v. M. P. M., Inc., 397 F. Supp. 78 (D. Colo. 1975). *See* Granader v. Public Bank, 417 F.2d 75 (6th Cir. 1969) (summary dismissal of Section 7 complaint affirmed after state court receivership proceedings had found Public Bank insolvent and acquirer only prospective purchaser). For cases in which the defense was unsuccessful, see, for example, United States v. Greater Buffalo Press, Inc., 402 U.S. 549 (1971); Citizen Publ'g Co. v. United States, 394 U.S. 131 (1969); United States v. Third Nat'l Bank in Nashville, 390 U.S. 171 (1968); United States v. Von's Grocery Co., 384 U.S. 270 (1966); United States v. El Paso Natural Gas Co., 376 U.S. 651 (1964); United States v. Philadelphia Nat'l Bank, 374 U.S. 321, 372 n.46 (1963); United States v. Diebold, Inc., 369 U.S. 654 (1962); Michigan Citizens for an Independent Press v. Thornburgh, 868 F.2d 1285, 128788, (D.C. Cir. 1989) (Newspaper Preservation Act); United States v. Energy Sols., Inc., 265 F. Supp. 3d 415, 444-45 (D. Del. 2017); FTC v. ProMedica Health Sys., Inc., 2011 WL 1219281, at *57 (N.D. Ohio 2011); FTC v. Harbour Group Invs., L.P., Civ. No. 90–2525, 1990 WL 198819 (D.D.C. Nov. 19, 1990); FTC v. Bass Bros. Enters., Inc., 1984 WL 355 (N.D. Ohio 1984). The failing-firm defense has never succeeded in a Section 13(b) proceeding. *See* FTC v. ProMedica Health Sys., Inc., 2011 WL 1219281, at *57 (N.D. Ohio 2011).

6 *See* Citizen Publ'g Co. v. United States, 394 U.S. 131, 136-39 (1969); International Shoe Co. v. FTC, 280 U.S. 291, 302 (1930); FTC v. University Health, Inc., 938 F.2d 1206, 1220 n.28 (11th Cir. 1991); Michigan Citizens for an Independent Press v. Thornburgh, 868 F.2d 1285, 1287-88 (D.C. Cir. 1989); California v. Sutter Health Sys., 130 F. Supp. 2d 1109, 1133 (N.D. Cal. 2001); Reilly v. Hearst Corp., 107 F. Supp. 2d 1192, 1203 (N.D. Cal. 2000); FTC v. Harbour Group Invs., L.P., Civ. No. 90–2525, 1990 WL 198819 (D.D.C. Nov. 19, 1990).

not realistic.[7] The defense has been narrowly construed, and the company invoking it has the burden of establishing each element of the defense.[8]

Under the Supreme Court's *Citizen Publishing* decision, a failing company within the meaning of the defense is one whose "resources are so depleted and the prospects of rehabilitation so remote that it faces grave probability of business failure."[9] The failure requirement is established through an analysis of the allegedly failing company's financial condition prior to and at the time of acquisition, together with an examination of its future business prospects, its relationships with banks and other potential creditors, and its available working capital. The objective facts must support the conclusion that the company is failing or that its failure is imminent; the company's good faith intention to go out of business because its return is subjectively insufficient will not establish the failure requirement.

The alternative purchaser requirement is usually the reason that the defense fails.[10] The difficulties in establishing this element may be illustrated by contrasting United States v. M.P.M., Inc.,[11] with FTC v. Harbour Group Investments, L.P.[12] In MPM, the district court found that the parties had discharged their burden, because immediately after Mobile's bank had informed the company that it had to raise $200,000 in new capital before further credit would be extended, the company embarked on exploring "virtually every potential source of funding." [13] Mobile's president contacted numerous firms, government agencies and other possible funding sources. One of the major shareholders devoted virtually all of his time to finding new funding in order to maintain the company as a viable enterprise. The court found that not only were the contacts numerous, but also that each person approached was a credible potential source of new capital. Only Pre-Mix, whose combination with Mobile was challenged, was willing to become involved with the company; the others declined because they

7 *See, e.g.*, Dr. Pepper/Seven-Up Cos., v. FTC, 991 F.2d 859, 86465 (D.C. Cir. 1993); U.S. Steel Corp. v. FTC, 426 F.2d 592, 608-09 (6th Cir. 1970); *In re* The Pillsbury Co., 93 F.T.C. 966, 1031-33, 1979 WL 44683 (1979); *In re* Reichhold Chems., Inc., 91 F.T.C. 246, 289-91, 1978 WL 206094 (1978). The requirement appears to have been suggested, but not formalized, in Citizen Publ'g Co. v. United States, 394 U.S. 131, 138 (1969). Two courts have suggested that the *Citizen Publishing* language did not add a new element to the failing company defense. *See* United States v. Black & Decker Mfg. Co., 430 F. Supp. 729, 778 (D. Md. 1976); United States v. M. P. M., Inc., 397 F. Supp. 78, 96 (D. Colo. 1975).

8 *See, e.g.*, FTC v. Harbour Group Invs., L.P., Civ. No. 90–2525, 1990 WL 198819 (D.D.C. Nov. 19, 1990); United States v. G. Heileman Brewing Co., 345 F. Supp. 117, 123 (E.D. Mich. 1972).

9 Citizen Publ'g Co. v. United States, 394 U.S. 131, 137 (1969).

10 *See, e.g.*, Dr. Pepper/Seven-Up Cos., Inc. v. FTC, 991 F.2d 859, 862 (D.C. Cir. 1993) (rejecting failing company defense because it "had no adequate basis to determine whether Honickman [was] the sole plausible acquirer") (citation omitted).

11 United States v. M.P.M., Inc., 397 F. Supp. 78 (D. Colo. 1975).

12 FTC v. Harbour Group Invs., L.P., Civ. No. 90–2525, 1990 WL 198819 (D.D.C. Nov. 19, 1990).

13 United States v. M.P.M., Inc., 397 F. Supp. 78, 101 (D. Colo. 1975).

considered Mobile an unacceptable business risk. Moreover, Pre-Mix had emerged as a candidate months after many of the other contacts had been made.[14]

By contrast, in *Harbour Group* the search for alternative acquirers did not begin until after an agreement had been struck on the challenged acquisition. Moreover, although an investment bank was retained to perform the search, it was contacted by the acquiring company, not the acquired company, and was given only a few weeks to conduct the search despite the fact that the original purchase agreement took months to negotiate. Nor did the investment bank's efforts comport with its usual manner of searching for potential acquirers. The investment bank team handling the search was not one experienced in selling small companies, the investment bank distributed only minimal offering materials, and the search consisted of a few exploratory telephone calls with little or no follow-up. The *Harbour Group* court concluded that the merging parties did not fulfill their burden of proving that no alternative purchaser existed.

The requirement added by some courts that the acquired firm must not be able to reorganize under the bankruptcy laws into a viable economic enterprise has two significant implications for the failing company defense.

First, it may almost be impossible for the merging companies to discharge their burden of proof under this requirement. Reorganization proceedings can be extremely complicated. In many situations, reorganization plans have been confirmed after lengthy negotiations, despite expectations at the beginning of the process that the plan would fail and the company would be liquidated. Indeed, perhaps the only good way to prove this requirement is to show that the going concern value of the company is less than the company's liquidation value.

Second, when coupled with the first two requirements, the inability to reorganize implies that the acquired firm's assets will quickly exit the market absent the challenged transaction or an alternative buyer. This effectively converts the failing company defense from an affirmative defense to a negative defense. An affirmative defense is one that provides a justification for a transaction that threatens competition, but as to which the public interest in permitting the transaction outweighs the public interest in preventing any anticompetitive effects. A negative defense is one that negates an essential element of the plaintiff's case, in this instance the requirement that the transaction will threaten competition in the future. If a failing company merges with a competitor, the immediate economic effect will be to make the market marginally less competitive than it was before the transaction. However, if the transaction is disallowed, the failing company will exit the market, thereby making the market even less competitive through the loss of its productive capacity. From a forward-looking perspective, the market is more competitive with the transaction than it would be without the transaction.

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[14] *See* California v. Sutter Health Sys., 130 F. Supp. 2d 1109, 1136-37 (N.D. Cal. 2001) (finding an adequate search was undertaken and that no reasonable alternative purchaser existed). Where one party to a joint venture is failing and the other joint venture partner wishes to acquire it, the failing venturer does not have to be marketed with the venture intact if the terms of the joint venture agreement permit the successful joint venture partner to terminate the venture if the failing firm is sold to someone else. Reilly v. Hearst Corp., 107 F. Supp. 2d 1192, 1205 (N.D. Cal. 2000).

The courts have held that the failing company defense applies equally whether the failing firm is the buyer or the seller.[15] The courts are split as to whether the failing company defense may be invoked with respect to the acquisition of the failing part of a profitable company.[16]

The DOJ/FTC Guidelines approach

The DOJ and FTC always have been antagonistic to the failing company doctrine, but in deference to its long judicial acceptance the 2010 DOJ/FTC Horizontal Merger Guidelines, as have the earlier guidelines, include a section on failing companies.[17] Like the more demanding courts, the Guidelines recognize the defense only when: (1) the firm is failing in the sense that it is unable to meet its financial obligations in the near future; (2) the firm is unable to reorganize successfully under Chapter 11 of the Bankruptcy Act; and (3) the firm has made unsuccessful good-faith efforts to elicit reasonable alternative offers that would keep its tangible and intangible assets in the relevant market and pose a less severe danger to competition than does the proposed merger.[18]

There have been very few invocations of the failing company defense that have been successful before either the DOJ or the FTC. As before the courts, although it is relatively easy to show that the company or division is failing, historically it has been difficult to convince the agencies that the requisite effort has been made to find a less anticompetitive purchaser. Success means that the challenged transaction cannot go forward, and the agencies almost conclusively presume that the failure to find a less anticompetitive purchaser is the result of a failure of effort, not a real absence of alternative purchasers. This skepticism is compounded by the agencies' view, expressed in a footnote in the Guidelines, that any offer to purchase the assets of the failing firm or division at a price above liquidation value is a reasonable alternative offer that vitiates the defense.

The Guidelines, like many courts, extend the defense to failing divisions of otherwise healthy companies, although they emphasize that great care must be exercised in analyzing the division's cash flow to ensure that it is negative in an economically meaningful sense and not just an artifact of financial accounting. In

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15 *See* United States v. M.P.M., Inc., 397 F. Supp. 78, (D. Colo. 1975).

16 For cases finding the defense applicable to failing divisions, see FTC v. Great Lakes Chem. Corp., 528 F. Supp. 84, 96 (N.D. Ill. 1981); United States v. Reed Roller Bit Co., 274 F. Supp. 573, 584 (W.D. Okla. 1967); United States v. Lever Bros. Co., 216 F. Supp. 887, 898-99 (S.D.N.Y. 1963). For cases finding the defense inapplicable to failing divisions, see United States v. Blue Bell, Inc., 395 F. Supp. 538, 550 (M.D. Tenn. 1975); United States v. Phillips Petroleum Co., 367 F. Supp. 1226, 1260 (C.D. Cal. 1973).

17 2010 DOJ/FTC Horizontal Merger Guidelines § 11.

18 *See* 2010 DOJ/FTC Horizontal Merger Guidelines § 11. The 1992 Guidelines included a fourth requirement: absent the acquisition under investigation, the assets of the failing firm would exit the relevant market. 1992 DOJ/FTC Horizontal Merger Guidelines § 5.1. The four-part 1992 Guidelines test has been adopted by some courts. *See* FTC v. Arch Coal, Inc., 329 F. Supp. 2d 109, 154 (D.D.C. 2004).

analyzing divisional cash flow, as well as in determining whether the division's assets will leave the market if the acquisition is unable to proceed, the agencies will require evidence beyond business plans or financial statements prepared by management.

Weak and competitively disadvantaged companies

In United States v. General Dynamics Corp.,[19] the DOJ challenged a merger between two coal companies that substantially increased market concentration. The Supreme Court held that the government's statistics on concentration did not accurately forecast competitive conditions in the relevant market. The focus of competition in the coal market was found to be the procurement of new long-term supply contracts. Because the acquired coal company's available reserves had already been committed to long-term supply contracts, the Court concluded that its probable future ability to compete had been exhausted and that its removal by merger would not adversely affect competition in the future. The Court supported its conclusion with the following observation:

> Evidence of past production does not, as a matter of logic, necessarily give a proper picture of a company's future ability to compete . . . Irrespective of the [acquired company's] . . . size when viewed as a producer, its weakness as a competitor . . . fully substantiated [the district court's] . . . conclusion that its acquisition . . . would not substantially . . . lessen competition.[20]

Since the *General Dynamics* decision, some courts have relied, at least in part, on evidence of a company's weak financial condition to permit a merger, notwithstanding a *prima facie* proof of anticompetitive effect based on the *Philadelphia National Bank* presumption using current market shares.[21] This is commonly known as the "flailing company" defense. The general idea is that the financial condition of the weak firm indicates that its market share and more generally its competitive significance in the marketplace would rapidly decline in the future absent the merger, so that on a forward-looking basis the merger today would have little likelihood of an anticompetitive effect.[22] Under this logic, the flailing company defense is not a defense per se, but rather a recognition that the financial condition of a company can be a factor in a rebuttal to the *Philadelphia National Bank* presumption.[23] Under this

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[19] United States v. General Dynamics Corp., 415 U.S. 486 (1974).

[20] United States v. General Dynamics Corp., 415 U.S. 486, 501, 50304 (1974).

[21] *See, e.g.*, FTC v. Nat'l Tea Co., 603 F.2d 6 (8th Cir. 1979) (preliminary injunction denied because acquiring company was weak competitor and market was relatively competitive); United States v. Consolidated Foods Corp., 455 F. Supp. 108, 13537 (E.D. Pa. 1978) (declining sales and lack of technical ability of acquiring company); *see also* FTC v. Arch Coal, Inc., 329 F. Supp. 2d 109, 153 (D.D.C. 2004); FTC v. Tenet Healthcare Corp., 17 F. Supp. 2d 93 (E.D. Mo. 1998); United States v. Federal Co., 403 F. Supp. 161, 16669 (W.D. Tenn. 1975); United States v. M. P. M., Inc., 397 F. Supp. 78 (D. Colo. 1975).

[22] *See* FTC v. Arch Coal, Inc., 329 F. Supp. 2d 109, 157 (D.D.C. 2004); Dr. Pepper/Seven-Up Cos. v. FTC, 991 F.2d 859, 864-65 (D.C. Cir. 1993); Lektro-Vend Corp. v. Vendo Co., 660 F.2d 255, 276-77 (7th Cir. 1981); FTC v. Nat'l Tea Co., 603 F.2d 694, 699-700 (8th Cir. 1979).

[23] Kaiser Aluminum & Chem. Corp. v. FTC, 652 F.2d 1324, 1339 (7th Cir. 1981).

reading, to be successful the defendant must show that the weakness of the firm (together with any other relevant factors) not only results in the firm's nominal market share overstating its future competitive significance but also that the firm's expected future share absent the merger would be low enough so as not to trigger the *Philadelphia National Bank* presumption.[24]

The federal antitrust enforcement agencies and the courts have been very skeptical of arguments seeking to justify *prima facie* anticompetitive transactions on the grounds that one of the merging companies is financially weak or otherwise competitively disadvantaged.[25] Much of this skepticism appears to derive from the frequency with which somewhat less than believable claims of this sort historically have been advanced. Even when the claims of weakness or competitive disadvantage are believed, the agencies insist that the parties prove that the impediment cannot be overcome by some less anticompetitive means than the proposed acquisition. In effect, the agencies adopt a standard very similar to the standard they employ in the failing company defense.

[24] FTC v. University Health, Inc., 938 F.2d 1206, 1221 (11th Cir. 1991) (articulating the failing firm defense as requiring the defendant to show that "the government's market share statistics overstate the acquired firm's ability to compete in the future and that, discounting the acquired firm's market share to take this into account, the merger would not substantially lessen competition"); *accord* FTC v. ProMedica Health Sys., Inc., 2011 WL 1219281, at *58 (N.D. Ohio 2011).

[25] *See* FTC v. Warner Commc'ns Inc., 742 F.2d 1156, 1164-65 (9th Cir. 1984) (noting that other cases have provided "persuasive reasons for rejecting or attaching little weight to a defense of financial plight as a ground for justifying a merger"); FTC v. ProMedica Health Sys., Inc., 2011 WL 1219281, at *58 (N.D. Ohio 2011) ("Courts have viewed the defense with extreme skepticism, describing it as 'probably the weakest ground of all for justifying a merger.'") (citing Kaiser Aluminum & Chem. Corp. v. FTC, 652 F.2d 1324, 1338-41 (7th Cir. 1981)).