UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

UNITED STATES OF AMERICA,

Plaintiff,

v.

APPLE, INC.,
HACHETTE BOOK GROUP, INC.,
HARPERCOLLINS PUBLISHERS L.L.C.,
VERLAGSGRUPPE GEORG VON HOLTZBRINCK GMBH,
HOLTZBRINCK PUBLISHERS, LLC d/b/a MACMILLAN,
THE PENGUIN GROUP, A DIVISION OF PEARSON PLC,
PENGUIN GROUP (USA), INC., and
SIMON & SCHUSTER, INC.,

Defendants.

Civil Action No. 1:12-CV-2826

COMMENTS OF BARNES & NOBLE, INC. ON THE PROPOSED FINAL JUDGMENT

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Barnes & Noble, Inc. ("Barnes & Noble") respectfully submits the following comments pursuant to Section 2(b) and 2(d) of the Antitrust Procedures and Penalties Act, 15 U.S.C. § 16(b)-(h) (the "Tunney Act"), relating to the Proposed Final Judgment that was submitted on April 11, 2012, by the United States and Defendants Hachette Book Group, Inc., HarperCollins Publishers L.L.C., and Simon & Schuster, Inc. (the "proposed settlement").

INTRODUCTION

The proposed settlement represents an unprecedented effort by the Antitrust Division of the U.S. Department of Justice (the "Government" or the "Division") to reject its traditional role of ending alleged collusion and to become instead a regulator of a nascent technology industry that it little understands. The proposal is not a run-of-the-mill Tunney Act anti-collusion order. Nor is it supported by the Government's complaint. The proposed settlement, particularly its overreaching regulatory provisions, warrants an exacting review because of its potential impact on the national economy and culture, including the future of copyrighted expression and bookselling in general, not only electronic books ("e-books"). Because of the far-reaching implications of the proposed settlement, many millions of Americans, as well as all levels of the distribution chain for books (from authors to publishers to distributors, and especially brick-and-mortar stores), stand to be affected by this case's resolution.

The proposed settlement will transform the Division into a regulator, in particular through remedies not sought or mentioned in the complaint filed by the United States (the "Complaint"). The Complaint does not dispute the legality of agency itself. Nor can it, as the agency model is widely used and perfectly legal. Nor does the Complaint challenge the ability of publishers and distributors to negotiate agreements that are in their respective individual

economic interests. It is also important to note that the Complaint does not even seek the regulatory remedies embodied in the proposed settlement.

The proposed settlement, in direct contrast to the Complaint, would for two years regulate the terms of publishers' agency contracts, requiring publishers to terminate their current agency agreements and then forbidding those same parties from entering *legal* agency agreements. This new regulatory regime will injure innocent third parties, including Barnes & Noble, independent bookstores, authors, and non-defendant publishers; hurt competition in an emerging industry; and ultimately harm consumers. The proposed settlement seeks to end agency arrangements that are common place in many industries and *that have brought more competition to the sale of e-books*. The detailed new regulations will also create complex compliance issues and require ongoing oversight by the Division and this Court. Not surprisingly, industry stakeholders have widely denounced the proposed settlement as damaging to the book industry and harmful to the public interest.

The basis for this proposed settlement is the Complaint, alleging that certain publishers have colluded to *lower* their own profits and increase their payments to e-book distributors such as Barnes & Noble. If that is a valid theory of collusion, and if the aim here is to end collusion, the proposed settlement should enjoin collusion and punish the purported colluders. Even in the most egregious cases of price fixing, the Division does not adopt price controls to remedy the effect on the market of agreed-to prices; it instead enjoins collusion and punishes the alleged collaborators. By contrast, the proposed settlement here imposes a regulatory regime that punishes only third parties and consumers. While the Division traditionally, and appropriately, seeks to prevent future violations and permit the market to determine prices, the proposed settlement seeks to substitute regulation for market forces.

Moreover, the Complaint explains that, if collusion is ended, no regulation of agency contracts is needed. The Complaint expressly states that, without collusion, parties will only enter new agency contracts when those agreements are in their independent self-interests because there are costs to such contracts. The Division nonetheless would impose a specific business model on an industry—government action which is analogous to a cartel imposing a detailed business model on publishers.

The end loser of this unnecessary and burdensome regulatory approach will be the American public, who will experience higher overall average e-book and hardback prices and less choice, both in how to obtain books and in what books are available. Barnes & Noble has witnessed how agency contracts have created competition by making publishers—where there are many players and where competition is abundant—responsible for pricing and price competition. In just two years, the result of agency contracts has been significant, as competition at all levels of the e-book distribution chain has increased. Amazon, which formerly sold 90 percent of e-books, still is responsible for approximately 60 percent of e-book sales; however, as a result of the adoption of the agency model, Barnes & Noble, Apple, independent booksellers, and others have been able to establish presences and begin to compete effectively for e-book sales. The fact is that agency has resulted in lower e-book prices, lower hardback prices, substantially lower wholesale e-book prices, and increased the quality and availability of e-books.

At the same time, the agency model has enabled innovation, with e-book distributors developing new products to differentiate themselves. Agency has encouraged new participants to invest in e-books. Barnes & Noble, for example, has introduced multiple versions of its e-reader, the NOOK; a self-publishing platform, PubIt!; and lending and Read-in-Store programs.

The competition with Barnes & Noble and others also has led to Amazon responding with improved e-readers of its own. The ultimate beneficiary has been the consumer, who has enjoyed more choice and more competition on products and service. Thus, it is truly unfortunate and misguided that the proposed settlement seeks to undo and regulate contracts that have protected competition and consumers.

The Tunney Act requires a court to reject a proposed final judgment that is not in the "public interest." 15 U.S.C. § 16(e). In making this determination, the court is "advised to pay special attention to the potential of any remedy to inflict harm upon third parties." *United States v. Microsoft Corp.*, 231 F. Supp. 2d 144, 181 (D.D.C. 2002); *accord United States v. Microsoft Corp.*, 56 F.3d 1448, 1462 (D.C. Cir. 1995) ("if third parties contend that they would be positively injured by the decree, a district judge might well hesitate before assuming the decree is appropriate"). The Tunney Act also requires that the Government present some *factual basis* for the proposed settlement remedies. *United States v. SBC Commc'ns, Inc.*, 489 F. Supp. 2d 1, 17 (D.D.C. 2007).

The Government has utterly failed to make any effort to meet its legal burden with respect to the provisions of the proposed settlement that would adopt two years of detailed regulations for agency contracts. The Government's own Complaint instead shows why the regulatory provisions of the proposed settlement are unnecessary and overreaching. Given the importance of this case to the national economy, our nation's culture, and the future of copyrighted expression, as well as the concerns raised by industry stakeholders, the proposed settlement deserves the close scrutiny of this Court.

Following the required review, the Court should reject the regulatory provisions of the proposed settlement as being against the public interest. To reject these regulatory provisions,

Barnes & Noble is not asking the Court to forbid Amazon or anyone else from pursuing whatever business model they may legitimately believe serves their interests. What Barnes & Noble is asking is that this Court not, through the adoption of the regulatory provisions of the proposed settlement, prevent Barnes & Noble from agreeing with individual publishers on a business model that is the product of bilateral good faith negotiations that both parties agree are in their best interests. The agency model agreed by Barnes & Noble and the publishers is pro-consumer: it has proven to encourage and stimulate competition in a market that previously was characterized by one dominant player and a lack of competition.

I. BACKGROUND

A. The Division's Allegations and Proposed Settlement.

On April 11, 2012, the same day that it filed the proposed settlement, the Government also filed its Complaint alleging Sherman Act Section 1 antitrust claims against the settling publishers as well as The Penguin Group and Penguin Group (USA), Inc.; Verlagsgruppe Georg von Holtzbrinck GmbH; Holtzbrinck Publishers, LLC d/b/a Macmillan; and Apple. The Complaint is as noteworthy for what it does not say as what it does. The Complaint does not suggest that agency itself is illegal. Nor does it challenge the ability of publishers and distributors to negotiate agreements that are in the economic interests of each individually, even if those terms allow publishers, instead of distributors, to set the retail prices of their works.

What the Complaint does attack is purported collusion among the defendants, as well as a retail price most-favored-nations clause ("MFN") and a price-tier provision that the Division argues are anticompetitive. (Compl. ¶¶ 94-103) To address the alleged collusion and the MFN and price-tier provisions, the Complaint requests several traditional remedies:

- A declaration that Defendants unlawfully colluded;

- An injunction against Defendants from engaging in collusion in violation of Section 1 of the Sherman Act;
- A prohibition on the setting of price tiers in agency contracts;
- Termination of current agency agreements that require publishers to determine prices;
- Reformation of the agreements to strike retail price MFNs; and
- Costs of the action.

(Compl. ¶ 104 – Requests for Relief)

Unlike the Complaint, the proposed settlement seeks to regulate future contracts in the e-book industry. For a period of two years, the proposed settlement bars *any* contract, preexisting or not, that puts restrictions on distributor pricing, with complicated exceptions. (Proposed Settlement ¶¶ V.A-B) It thus requires, for two years, that pricing decisions be left to e-book distributors, preventing publishers from setting their own independent prices for their own works. Nothing like this proposed relief is found in the Government's Complaint or would be ordered by a Court if the Government prevailed at trial.

The proposed settlement would adopt regulation of vertical pricing models that is inconsistent with Supreme Court cases holding that manufacturers' control over their own prices can be pro-competitive. The Supreme Court has recognized that price setting by manufacturers (rather than distributors) may stimulate interbrand competition by encouraging retailers to invest in services and promotional efforts, discouraging free riding by discounting retailers on retailers providing services, and facilitating market entry by new firms and brands (all of which was observable following agency in this case). *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 551 U.S. 877, 889-92 (2007); *see Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36, 54-

57 (1977). By contrast to the approach taken by the proposed settlement here, the United States has also previously told the Supreme Court that "there is a widespread consensus that permitting a manufacturer to control the price at which its goods are sold may promote *inter*brand competition and consumer welfare in a variety of ways." *Leegin Creative Leather Prods.*, 551 U.S. at 889 (quoting Brief for United States as Amicus Curiae) (emphasis in original).

Moreover, the proposed settlement regulates the terms of any future agency agreements, regardless of whether those agreements are the product of independent negotiation and are in the parties' economic interests. (Proposed Settlement ¶¶ V.A-C) It also requires the settling publishers to do business with any distributor, even if that distributor charges below direct cost or is free riding on distributors providing services, with long-term adverse consequences to the publishers' distribution channels. (*Id.* ¶ V.D) Under the proposed settlement, the Division will serve as regulator of the e-book industry, reviewing on a quarterly basis all agreements entered between the settling publishers and any e-book distributor. (*Id.* ¶ IV.D)

The regulations also include complicated exemptions. Notwithstanding the two-year ban on agency contracts, agency agreements may be entered

> under which the aggregate dollar value of the price discounts or any other form of promotions to encourage consumers to Purchase one or more of the Settling Defendant's E-books (as opposed to advertising or promotions engaged in by the E-book Retailer not specifically tied or directed to the Settling Defendant's E-books) is restricted.

(*Id.* ¶ VI.B)

This is not all, however:

> *provided that* (1) such agreed restriction shall not interfere with the E-book Retailer's ability to reduce the final price paid by consumers to purchase the Settling Defendant's E-books by an aggregate amount equal to the total commissions the Settling Defendant pays to the E-book Retailer, over a period of at least one year, in connection with the Sale of the Settling Defendant's E-books to consumers; (2) the Settling Defendant shall not restrict, limit, or impede the E-

> book Retailer's use of the agreed funds to offer price discounts or any other form of promotions to encourage consumers to Purchase one or more E-books; and (3) the method of accounting for the E-book Retailer's promotional activity does not restrict, limit, or impede the E-book Retailer from engaging in any form of retail activity or promotion.

(*Id.*)

It is inconceivable that, should the Government prevail in this case, such a complicated and overreaching regulatory system, which is not even included in the relief requested in the Complaint, would be adopted by a court. There is also no record before the Court to justify the regulatory provisions of the proposed settlement. To the contrary, the Government states in its Competitive Impact Statement and its Complaint that, under its theory, these regulatory provisions are entirely unnecessary. The Government expressly argues that agency contracts or any unilateral attempts by publishers to curtail distributor pricing decisions entail substantial costs, including competition with a potential Amazon $9.99 price-point. (Competitive Impact Stmt. at 4-5; Compl. ¶¶ 5, 35-36, 38)

B. Barnes & Noble and the Brick-and-Mortar Bookstore.

Barnes & Noble is the largest bookseller in the United States, operating bookstores across all fifty states and maintaining one of the Internet's biggest e-commerce websites at www.barnesandnoble.com. Through its multiple distribution channels, Barnes & Noble offers customers easy and convenient access to physical books, e-books, magazines, newspapers, and other content. Barnes & Noble is a party to agency agreements, including those that it separately negotiated with each of the settling publishers: Hachette Book Group, Inc., HarperCollins Publishers L.L.C., and Simon & Schuster, Inc.

Barnes & Noble distributes its products through multiple channels and has built a strong e-commerce business. Its brick-and-mortar stores offer a wealth of community services and

function as showcases to promote books (including e-books). Bookstores provide unique experiences and services to consumers: community centers that offer browsing, in-person support, and services including children's events and literacy and education promotion.

Just as important as the consumer experience offered by brick-and-mortar retailers is the advertising and showroom space these stores provide for new works and authors. As a top executive at a (non-defendant) publisher has noted: "That display space they have in the store is really one of the most valuable places that exists in this country for communicating to the consumer that a book is a big deal." Julie Bosman, *The Bookstore's Last Stand*, N.Y. Times, Jan. 28, 2012 (quoting Madeline Intosh, President, Sales, Operations, and Digital, Random House). Studies have repeatedly shown that these showcases drive book sales, both inside the store and online. *Id.* ("only a third of the people who step into a bookstore and walk out with a book actually arrived with the specific desire to buy one").

C. The e-Book Industry Prior to the Agency Agreements.

Barnes & Noble began selling e-books in July 2009, and its e-reader, the NOOK, went on the market in the fall of that same year. Prior to Barnes & Noble opening its e-bookstore in July 2009, Amazon was essentially the only e-book distributor in the United States. It enjoyed a dominant presence in the new industry with more than 90 percent of e-book sales, due to a lack of competition in both e-book and e-reader sales as well as below-cost pricing in significant instances that deterred other e-book distributors from entering the e-book space. Barnes & Noble sought to compete against Amazon in e-books and later e-readers with the introduction of the NOOK in the fall of 2009. However, as a result of Amazon's pricing (which priced most bestselling books sold by Barnes & Noble below Barnes & Noble's, and Amazon's, direct costs), Barnes & Noble was losing substantial money in an effort to compete with Amazon's pricing,

and was unable to gain significant market share. Other potential e-book distributors declined to enter the industry.

The consequence, by late 2009, was that publishers were facing the prospect of a single significant distributor for their e-book products. This was particularly troubling for publishers because if any single distributor with a proprietary e-book format established an exclusive or dominant position during the initial phase of the developing e-book business, it would be difficult or impossible for other distributors to begin competing later. Moreover, a dominant position in e-book distribution could lead to a dominant position in the distribution of traditional books as well, with further adverse consequences to publishers and, of course, consumers. It is to avoid just such consequences that the Supreme Court has repeatedly recognized the importance of permitting manufacturers to control who distributes their products and at what prices. *See Leegin Creative Leather Prods., Inc.*, 551 U.S. at 889-92; *Continental T.V. Inc.*, 433 U.S. at 54-57.

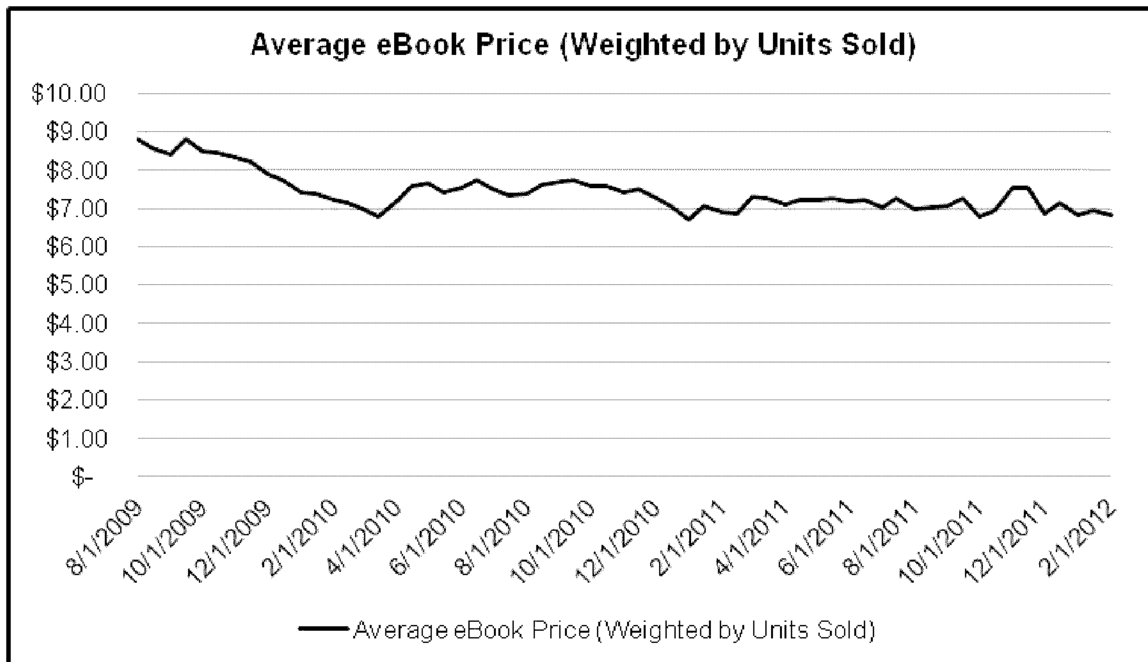
D. Agency Agreements and Competition.

The e-book industry became more competitive in 2010 when a number of publishers began distributing their e-books through an agency model and entered into agency agreements with e-book distributors, including Barnes & Noble. Under this system, pricing was controlled not by a single dominant player, but by numerous competitor publishers who compete vigorously among themselves. The model also permitted publishers to preserve conditions for long-term competition in the distribution of their products, which benefitted consumers as well as the publishers, despite the immediate loss of revenues to publishers from increased payments to distributors.

There was nothing unique at this time or now about agency, which is a standard business model in many industries; for example, Barnes & Noble distributes magazines and newspapers through an agency-like commission model, and Apple uses agency agreements across its eco-system for a wide range of products. Jared Newman, *Justice Department Threatens Apple, Publishers over E-Book Pricing*, Time, Mar. 8, 2012; *Apple Rejects E-Book Pricing Collusion Charge*, Reuters, Apr. 13, 2012.

Agency (or commission) contracts have also long been recognized as legal. *Morrison v. Murray Biscuit Co.*, 797 F.2d 1430, 1437 (7th Cir. 1986) (the agency model is simply an example of principals "telling their agents what price to charge the consumer"). It cannot "seriously be argued that the ancient and ubiquitous practice of principals' telling their agents what price to charge the consumer is just some massive evasion of the rule against price fixing." *Id.* at 1437. The Government also has not challenged the legitimacy or legality of agency in its Complaint.

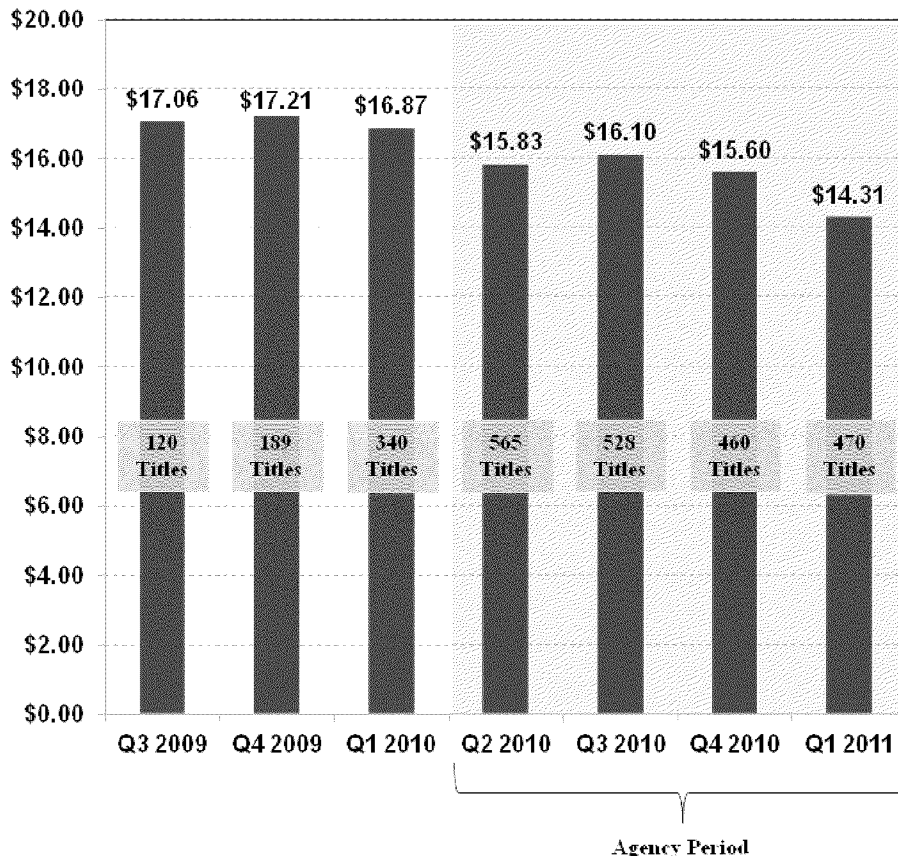
Under agency, publishers have engaged in vigorous competition on price, which, contrary to the superficial pricing analysis in the complaints before the Court, has resulted in lower e-book prices:



By shifting pricing decisions to a less concentrated sector of the industry (publishing), agency has allowed competition to thrive in e-book sales, both among publishers and distributors. Barnes & Noble has presented information to the Division illustrating how consumers have enjoyed the byproducts of that competition, including lower e-book and hardcover prices, more availability, and greater choice. On the retail side, agency has eliminated an artificial price point, enabling new competitors, including Barnes & Noble, to gain a presence in the industry and encouraging others to enter. These distributors now compete on service and innovation, instead of price alone, which has led to an enhanced e-book experience for consumers.

The benefits of agency to American consumers are easily identifiable. Competition is now vigorous among e-book distributors. Amazon's share of e-book sales has decreased to approximately 60 percent, while Barnes & Noble, Apple, independent booksellers, and others have emerged to provide consumers more choice in where and how they shop for e-books. *See* Amy Martinez, *Amazon.com Trying to Wring Deep Discounts From Publishers*, Seattle Times, Apr. 1, 2012.

Data presented to the Division shows that, under agency, prices have declined in a number of areas including average wholesale e-book prices charged by publishers (which means that the alleged conspiracy was intended *to reduce publisher profits*). In addition, average e-book retail prices have declined, as have hardback retail prices:



* Average hardback prices weighted by e-book total sales. Only includes hardback titles where there is a corresponding e-book.

At the same time, quality and availability—in the form of faster e-book releases (often simultaneous with a book's hardback edition)—have increased. When publishers were unable to control the pricing of e-books, the only way they could prevent cannibalization of hardback book sales was to hold back e-book releases. Data presented to the Division shows that the average period of delay—or window—between hardback and e-book release among the defendant

publishers prior to agency was 22 days. In the eight months following the implementation of agency contracts, that number fell to three days, essentially eliminating for consumers the delay in publication of an e-book after a hardcover book. Data provided to the Division also shows that non-defendant publishers who did not enter agency agreements continued to delay their e-book releases. Consequentially, when e-book prices are compared before-and-after agency contracts, the comparison is of different quality products: an e-book released simultaneously with a hardcover is not the same as one released weeks later.

Further, innovation has flourished, as agency has encouraged new participants to invest in e-books. Barnes & Noble alone has introduced multiple versions of its e-reader, the NOOK; a self-publishing platform, PubIt!; and lending and Read-in-Store programs. The competition with Barnes & Noble and others also has led to Amazon responding with improved e-readers of its own.

Today, the American consumer enjoys more competition on price, service, and products in the e-book industry than ever before, thanks to the agency model. Remarkably, the Division has ignored all these benefits and focused exclusively, and short-sightedly, on increased prices of *some* e-books it has identified (e-books that are no longer delayed) to propose a settlement that threatens to destroy competition in this young thriving industry.

II. THE TUNNEY ACT REQUIRES REJECTION OF OVERBROAD SETTLEMENTS THAT ARE NOT IN THE "PUBLIC INTEREST" AND NOT SUPPORTED BY A FACTUAL RECORD TO SUPPORT THE REQUESTED REMEDIES.

Under the Tunney Act, courts must reject proposed final judgments that are not in the "public interest." 15 U.S.C. § 16(e)(1). As the legislative history of the Act makes clear, courts are not to "rubber stamp" proposed consent decrees; rather, they must "make an independent determination as to whether or not entry of a proposed consent decree is in the public interest."

H. Rep. No. 93-1463, at 6 (1974), *as reprinted in* 1974 U.S.C.C.A.N. 6535, 6538; S. Rep. No. 93-298, at 5 (1973); *see also* 150 Cong. Rec. S3615, 3618 (Apr. 2, 2004) (statement of Sen. Kohl) (purpose of amendments to the Tunney Act was "to preclude a court from engaging in 'rubber stamping' of antitrust consent decrees, but instead to seriously and deliberately consider these factors in the course of determining whether the proposed decree is in the public interest").

In making this determination, courts are required to consider, among other things, the impact of the proposed judgment on "the relevant market or markets" and the "public generally." 15 U.S.C. § 16(e)(1)(B). This includes potential injury to third parties. *Microsoft*, 56 F.3d at 1462 ("certainly, if third parties contend that they would be positively injured by the decree, a district judge might well hesitate before assuming that the decree is appropriate"). "[C]ourts considering antitrust remedies are advised to pay special attention to the potential of any remedy to inflict harm upon third parties." *Microsoft Corp.*, 231 F. Supp. 2d at 181.

Courts must also analyze the relationship between the allegations set forth in the complaint and the remedy imposed by the final judgment. *Microsoft*, 56 F.3d at 1460-61; 15 U.S.C. § 16(e)(1)(A). The Government must "provide a factual basis for concluding that the settlements are reasonably adequate remedies for the alleged harms." *SBC Commc'ns*, 489 F. Supp. 2d at 17; *accord United States v. Abitibi-Consolidated Inc.*, 584 F. Supp. 2d 162, 165 (D.D.C. 2008) ("If there is a factual basis for concluding that the divestiture is a reasonably adequate remedy for the harm predicted in the Complaint, then the settlement should be approved. If there is not, then the settlement should be rejected").

Further, when the relief sought in the proposed settlement is unrelated to the violations alleged in the complaint, that relief should not be ordered. *SBC Commc'ns*, 489 F. Supp. 2d at 17; *see Microsoft*, 56 F.3d at 1460 ("Even where the government has proved antitrust violations

at trial, the remedies must be of the 'same type or class' as the violations, and the court is not at liberty to enjoin 'all future violations of the antitrust laws, however unrelated to violations found by the court'" (quoting *Zenith Radio Corp. v. Hazeltine Research, Inc.*, 395 U.S. 100, 132-33 (1969)). A district court should extend "deference to the Government's evaluation of the case and the remedies available to it," *United States v. Keyspan Corp.*, 763 F. Supp. 2d 633, 643 (S.D.N.Y. 2011), but it does not follow "that courts must unquestionably accept a proffered decree as long as it somehow, and however inadequately, deals with the antitrust and other public policy problems implicated in the lawsuit," *United States v. Am. Tel. & Tel. Co.*, 552 F. Supp. 131, 151 (D.D.C. 1982).

The district court should be particularly concerned, as is the case here, where there is no record to justify the proposed relief. In other words, there must be some factual record justifying the relief imposed in the proposed settlement. *See SBC Commc'ns*, 489 F. Supp. 2d at 9 (the court previously concluded that there was "insufficient material in the record, which consisted largely or exclusively of unverified legal pleadings" to allow it to adequately discharge its duties under the Tunney Act and requiring the Government to provide further materials). As set forth above, this is not a run-of-the-mill Tunney Act anti-collusion order. This is the type of case—and broad relief—that merits even closer scrutiny. *See Am. Tel. & Tel. Co.*, 552 F. Supp. at 151-52 (articulating why closer review of proposed settlement was necessary in the AT&T cases, including potential impact of decree on important sector of economy and general public interests).

The proposed settlement requires close scrutiny because of its potential impact on the national economy and culture, including the future of copyrighted expression and bookselling in general (not just e-books). Because of the far-reaching implications of the proposed settlement,

millions and millions of Americans and the distribution chain for books—authors, publishers, distributors, and brick-and-mortar stores—will be affected by this case's resolution.

Additionally, the public, including elected representatives of Congress, do not believe the proposed settlement serves the public interest. Since the initiation of the Government's lawsuit and the announcement of the proposed settlement, thoughtful articles and newspapers have appeared in numerous national publications critical of the Division's course of action in this case. *E.g.*, David Carr, *Book Publishing's Real Nemesis*, N.Y. Times, Apr. 15, 2012; Jordan Weissman, *The Justice Department Just Made Jeff Bezos Dictator-for-Life*, The Atlantic, Apr. 12, 2012; William Petrocelli, *The Justice Department Jumps Into Amazon's Pocket*, Huffington Post, Apr. 24, 2012 ("The Justice Department lawyers have some soul-searching to do on this. . . . Right now, they have aligned themselves with the forces that threaten to destroy the book business, and that's a shameful place to be").

Major constituents in the industry have also criticized the suit and the proposed settlement. For example, authors have noted that the settlement will reduce competition and pose a threat to content diversity. *E.g.*, Scott Turow, President, Author's Guild, Letter ("Grim News") at the Author's Guild Blog, Mar. 9, 2012, http://blog.authorsguild.org/ 2012/03/09/letter-from-scott-turow-grim-news ("The irony bites hard: our government may be on the verge of killing real competition in order to save the appearance of competition"); Scott Turow, President, Author's Guild, *Apple Antitrust Suit Would Aid Amazon*, Bloomberg, Mar. 21, 2012 ("[I]f the government wants to intervene in the literary marketplace, I hope it will consider the complex ecology of bookselling in the U.S. Because if we reinstate the status quo before Apple's agency-model breakthrough, then bookstores and publishers are going to be the first casualties"). Non-defendant publishers have also questioned the proposed settlement. *E.g.*, Mark Coker, Founder

and CEO of the self-publishing company Smashwords, *A Dark Day for the Future of Books*, CNN, Apr. 15, 2012.

And even elected representatives have expressed strong reservations about the lawsuit and its ramifications. Senator Charles Schumer (D-N.Y.) summed up the public concern over the lawsuit and proposed settlement: "Rarely have I seen a suit that so ill serves the interests of the consumer." Peter Osnos, *Confused By the eBook Lawsuit? So Is Everyone Else*, The Atlantic, May 1, 2012 (quoting Senator Schumer).

The widespread public criticism of the lawsuit confirms the broad implications of the regulatory provisions of the settlement in this case, and thus requires this Court to conduct a searching review to protect and ensure that there is a factual basis for the settlement, including its provisions regulating future agency contracts. "None of this means, of course, that the Court would be justified in simply substituting its views for those of the parties. But it does mean that the decree [should] receive closer scrutiny than that which might be appropriate to a decree proposed in a more routine antitrust case." *Am. Tel. & Tel. Co.*, 552 F. Supp. at 153.

III. THE PROPOSED SETTLEMENT WILL INJURE THIRD PARTIES INCLUDING BARNES & NOBLE AND OTHER BRICK-AND-MORTAR STORES.

Here, the proposed settlement fails to meet the standards for approval under the Tunney Act. The settlement merits close scrutiny because it will positively harm Barnes & Noble and other brick-and-mortar stores by (1) declaring as null and void their agency contracts and forbidding the settling publishers from entering similar contracts with Barnes & Noble for two years except within complex regulatory exemptions; and (2) decreasing the payments that Barnes & Noble and other brick-and-mortar stores receive when they distribute e-books, thus

jeopardizing their investments in the e-book industry, encouraging free riding, and discouraging future investment and other entrants.

The proposed settlement is remarkable in that it does *nothing* to punish the purported colluding publishers and instead targets innocent third-parties such as Barnes & Noble. Under agency, as data submitted to the Division has shown, publishers make *less* money than they do under a wholesale arrangement. Distributors, such as Barnes & Noble, at the expense of publishers, enjoy somewhat greater profit margins, as they earn 30 percent commissions on the sales of e-books, as opposed to the negative profit margins they experienced under the wholesale model. In other words, the agency agreements are in Barnes & Noble's economic interests. And although the purported colluding publishers do achieve some benefits under agency in protecting the health of the e-book industry and ensuring competition, the fact is the publishers' bottomline, at least in the short term, is better under the wholesale model.

Thus, by *requiring* that settling publishers terminate their agency agreements with Barnes & Noble and by *forbidding* them to enter into similar agreements for two years, the Division is punishing Barnes & Noble—the wrong party.

This result can only hurt e-book consumers. Improved profitability has enabled distributors to invest substantially in the industry. Barnes & Noble alone has developed multiple versions of its e-reader, the NOOK; built a successful self-publishing platform, PubIt!; and initiated Read-in-Store and lending programs to cultivate e-book consumers and convert new ones over to the technology. It is these investments—fruits of the innovation that has flourished under agency—that are most at risk under the Division's proposed settlement.

The proposed settlement will also harm Barnes & Noble and other brick-and-mortar e-book distributors by leaving them where they were two years ago: a dominant player will set

uncompetitive prices that all other potential competitors must meet to compete. By requiring that distributors set e-book prices and limiting the ability of publishers to do so, the proposed settlement consolidates pricing in a highly concentrated sector of the industry—instead of the unconcentrated, competitive sector of publishers.

Unable to compete with below-cost pricing, e-book distributors will drop from the e-book space. Content diversity in that situation can only suffer. *See* Scott Turow, President, Author's Guild, *Apple Antitrust Suit Would Aid Amazon*, Bloomberg, Mar. 21, 2012 ("if we reinstate the status quo before Apple's agency-model breakthrough, then bookstores and publishers are going to be the first casualties. Right behind them will be readers, who will see the diversity of titles and authors diminish while leading titles get more expensive"). Consumers will also have limited choice in where they buy their books: online retailers such as Amazon or large, multipurpose brick-and-mortar stores such as Costco, Wal-Mart, and Target, which offer only mass-market selections.

The problem is most acute with brick-and-mortar stores. These stores have more overhead costs, costs that are required to maintain their book showrooms. These costs make artificial price points that are below direct costs, like the $9.99 one for e-books, even more unsustainable. Thus, in essence, the proposed settlement will relegate brick-and-mortar booksellers more and more to the margins of the book industry and to serve as free advertising and showrooms.

IV. THE PROPOSED FINAL JUDGMENT IS OVERBROAD AND PLACES ONEROUS REGULATIONS ON THE E-BOOK INDUSTRY THAT HAVE NO BASIS IN THE RECORD.

As the Government's Competitive Impact Statement notes, in seeking to have a court approve a proposed settlement under the Tunney Act, the Government must demonstrate "a

factual foundation for [its] decision such that its conclusions regarding the proposed settlement are reasonable." (Competitive Impact Stmt. at 19.) Remarkably, the Government has not even tried to meet this burden in this case. The broad regulations sought in the proposed settlement go far beyond what is needed to remedy the harms alleged, as evidenced by the relief requested by the Government in its Complaint. The proposed settlement provides for government regulation of *future* agency contracts. In essence, the Government has responded to purported price-fixing by implementing government controls of the market, rather than punishing the alleged colluders.

The very different relief sought in the Complaint is simple: termination of the offensive contracts, an injunction forbidding collusive activity, and restrictions on a retail price MFN and a price-tiering provision. (Compl. ¶ 104) These remedies are similar to the traditional relief that the Government seeks in price-fixing cases—*i.e.*, allowing innocent contracting counterparties the option to terminate the allegedly illegal contracts. *See Matter of Mem. Hermann Network Providers*, No. C-4104 (FTC) (Jan. 13, 2004) (allowing for termination of preexisting contracts "upon receipt by Respondent of a written request to terminate such contract from any payor").

By imposing these additional regulations, the proposed settlement goes beyond what is sufficient to cure any alleged violations and, by definition, lacks any factual relationship to the allegations in the Complaint. The Division has not even attempted to show how the remedies sought in the Complaint—filed the same day as the proposed settlement—are somehow insufficient and why relief beyond what was originally requested by the Government is necessary. As such, this Court should strike the portions of the proposed settlement that go beyond the remedies sought in the Complaint and make the Division a regulator of the e-book industry.

Here, the remedies requested in the Complaint also differ from traditional price-fixing relief by *requiring* the termination of the agreements. In addition to terminating the current contracts, the proposed settlement seeks to regulate *future* contracts for a period of up to two years. Specifically, it bars any future contract that puts restrictions on retailer pricing for a period of two years. (Proposed Settlement ¶¶ V.A, V.B) These provisions are also subject to complicated safe harbors that are difficult to implement or administer. The proposed settlement also prohibits price MFNs—which the Government broadly defines as including retail price MFNs, wholesale price MFNs, and commission MFNs (Proposed Settlement ¶ II.M; Competitive Impact Stmt. at 12-13), even though the Complaint seeks to bar only retail price MFNs (Compl. ¶¶ 104(d), 104(e)). (Proposed Settlement ¶ V.C)

To enforce these prohibitions, the proposed settlement provides that the settling publishers must furnish all agreements with e-book retailers to the Department of Justice on a quarterly basis. (*Id.* ¶ IV.D) In addition to regulating the contractual terms between the settling publishers and e-book distributors, the proposed settlement requires the settling publishers to do business with any e-book retailer, even when that retailer engages in pricing that is below direct cost. (*Id.* ¶ V.D)

These restrictions represent an unprecedented move from the Division's role as enforcer of the antitrust laws to regulator of an entire industry. Although that alone is extraordinary, the Government's proposed regulations in this case are even more remarkable in light of the fact that, *under the Division's theory of the case, the additional regulations are unnecessary*. As the Government recognizes in its Competitive Impact Statement and its Complaint, under its theory, future agency contracts or any unilateral attempts by publishers to curtail distributor pricing decisions would entail substantial costs, including competition with a potential Amazon below-

cost price-point driven not by market forces but instead the result of a dominant single significant player in the industry, as with the below-cost $9.99 price point that existed prior to agency. (Competitive Impact Stmt. at 4-5; Compl. ¶¶ 5, 35-36, 38) In evaluating the plausibility of the private plaintiffs' complaint in this case, the District Court has thus explained that, under the government's theory, in the absence of collusion: "The costs of such a unilateral switch to the agency model would be substantial." *In re Electronic Books Antitrust Litig.*, No. 1:11-md-02293-DLC, 2012 WL 1946759, at *12 (S.D.N.Y. May 15, 2012) (order on motion to dismiss).

What the Government does not, and cannot, explain is how, under its theory of the case, regulation of e-book agreements is necessary when, as it alleges, retail pricing restrictions are *against* the publishers' independent interests and involve substantial costs. If the settling publishers, absent collusion, would enter into only agreements in their independent interests, there is no need for additional government oversight or market regulation.

Moreover, absent collusion, agency agreements limiting retailer discretion over price are completely legal. As far back as *United States v. General Electric Co.*, 272 U.S. 476 (1926), the Supreme Court held that manufacturers, such as the publishers here, may lawfully set prices for their products when there is a genuine agency relationship. *Id.* at 488; *accord Valuepest.com of Charlotte, Inc. v. Bayer Corp.*, 561 F.3d 282, 286-88 (4th Cir. 2009), *cert. denied*, 130 S. Ct. 187 (2009); *Morrison*, 797 F.2d at 1437 (an agency model is simply an example of "the ancient and ubiquitous practice of principals' telling their agents what price to charge the consumer").[1] The

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1 *See also Simpson v. Union Oil Co. of Cal.*, 377 U.S. 13, 21 (1964) ("an owner of an article may send it to a dealer who may in turn undertake to sell it only at a price determined by the owner. There is nothing illegal about that arrangement"); *Day v. Taylor*, 400 F.3d 1272, 1276 (11th Cir. 2005) ("It is well-settled that 'genuine contracts of agency' do not constitute resale price maintenance because the 'owner of an article' is permitted to 'fix[] the price by which his agents transfer the title from him directly to the consumer'") (quoting *General Electric*, 272 U.S. at 488) (brackets in original); *Mularkey v. Holsum Bakery, Inc.*, 146 F.3d

Government should not regulate legal agreements that are independently negotiated by industry participants who are in the best position to determine if the agreements are in their interests.

Such action is tantamount to the Division substituting its views regarding the proper functioning of the e-book industry for that of competing industry participants. In essence, the proposed settlement substitutes one alleged cartel for a new cartel on the industry, albeit one run by the Division.

The comparison between the proposed settlement and the purportedly illegal agency agreements is striking in this regard. As a result of its negotiations with publishers, the Government alleges that Apple has acted as a conduit or hub for publishers to agree to (1) new agreements; (2) establishing a specific business model; (3) by publishers at the same time; and (4) on roughly equivalent terms. To remedy this, as a result of settlement negotiations with publishers, the Division has asked the Court to bless a (1) settlement agreement; (2) establishing a business model; (3) by publishers at the same time; and (4) on the same terms and, in fact, in a joint agreement. Everything the Government has done in this case, if done by Apple, under the Government's theory, would constitute anti-competitive collusion.

There is no basis in this record to support this assertion of regulatory power. And there is nothing in the record to indicate that the Division knows how to run the nascent e-book industry any better than the companies who have produced and sold books for generations. If the Division truly wants to "restore competition" to the e-book industry, it should punish the alleged

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1064, 1065 (9th Cir. 1998) (affirming judgment on Section 1 claim where the evidence showed, at most, defendant's unilateral price policy); *Tarrant Serv. Agency, Inc. v. Am. Standard, Inc.*, 12 F.3d 609, 617 (6th Cir. 1993) (no agreement where challenged broker policy was "unilaterally implemented by Trane"); *Apple Inc. v. Psystar Corp.*, 586 F. Supp. 2d 1190, 1203-04 (N.D. Cal. 2008) (dismissing Cartwright Act on the ground that it "alleges only unilateral anticompetitive conduct" even though Apple required all of its customers to enter into an end-user license agreement).

colluders, enjoin collusion, and allow and encourage industry participants to negotiate their own contracts and let market forces determine the course of the industry.

Even if extensive government regulation of an industry to remedy collusive price-fixing could ever be appropriate, this case does not present such a situation. Regulation of the e-book industry has far-reaching effects, as the sale of e-books has ramifications for the wider publishing and book industry. At the least, the Government and the Court should exercise extreme caution in changing the way in which an entire industry operates. *See United States v. Microsoft Corp.*, 253 F.3d 34, 80 (D.C. Cir. 2001) ("Absent some measure of confidence that there has been an actual loss of competition that needs to be restored, wisdom counsels against adopting radical structural relief"); *see also* Richard Epstein, Laurence A. Tisch Professor of Law, New York University School of Law, *Not Proven: The DOJ Suit Against Apple for eBook Pricing*, Apr. 11, 2012, http://ricochet.com/main-feed/Not-Proven-The-DOJ-suit-Against-Apple-for-eBook-Pricing ("It is a good rule of thumb to hold back from public enforcement when the relative balance is unclear").

Finally, it is important to note that the e-book industry is nascent. Government regulation at this stage in the industry's development raises a number of issues. For one, without the benefit of a historical industry track record, the Government cannot predict what effects its regulations will have on the industry, and thus it is ill-equipped to regulate the sale of e-books. In addition, any regulation of this new and evolving industry will have more pronounced, and lasting, effects than one of an established industry.

CONCLUSION

The proposed regulatory provisions of the settlement are not in the public interest. Given the widespread consequences of its unprecedented regulations, the lack of any factual basis to conclude that these regulations provide reasonably adequate remedies for the harms alleged the Complaint, and the harm that the regulations will inflict on innocent third parties, including Barnes & Noble, independent booksellers, authors, and non-defendant publishers, the proposed settlement should be substantially modified or rejected entirely.

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Respectfully submitted,

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