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John Read
Chief, Litigation III Section
Antitrust Division
U.S. Department of Justice
450 5th Street, NW, Suite 4000
Washington, DC 20530

Re: *United States v. Apple Inc., et al.*, 12-cv-02826 (DLC) (S.D.N.Y.) — Apple Inc.'s Tunney Act Comment: The Proposed Final Judgment Poses a Significant Threat to Future eBook Competition

Dear Mr. Read:

I write on behalf of Apple Inc. ("Apple") regarding the Proposed Judgment in the above-captioned matter.

The Proposed Judgment is a threat to eBook competition. In a misguided attempt to reshape the market[1] according to its own preferences, the Government seeks to impose a business model that will result in dramatic and long-lasting harm, in a manner not tailored to address the alleged wrongdoing, and without judicial findings of violations or consumer harm. eBook retailers such as Apple, authors, and ultimately consumers will, in the short and long term, suffer the consequences. This is troubling given that the Government has intervened in a rapidly growing and evolving market about which it appears to understand very little. Indeed, the Government's actions to date reflect a fundamental misunderstanding of eBook competition, Apple's role in the market, and the potential impact of this Proposed Judgment.

This is no ordinary decree. The breadth, scope, and detail of the Proposed Judgment are unprecedented. Under the decree, the Government and the Settling Defendants, not bilateral commercial negotiations, will define the business relationships between publishers and retailers. The Government, not the free market, will dictate the playing field of competition between and

[1] Apple's use of the term "market" herein is not intended to be, and is not, an admission or concession by Apple that the definition of the relevant market or markets advanced by any party in the underlying litigation is appropriate.

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among eBook retailers. And as a result it is the Government, not the rough and tumble of the marketplace, that will determine the winners and losers in the eBook business. The Proposed Judgment will have a direct and immediate impact on eBook retailers such as Apple and Barnes & Noble. Yet the Government appears not to have considered the extent of the likely impact of the Proposed Judgment on competition or on retailers, who—with the notable exception of Amazon—may be unable to continue to do business if the decree is approved. The Government has inexplicably decided to punish retailers, ***not*** the Settling Defendants—even though the Settling Defendants are the ones alleged to have colluded by meeting in secret to set prices. The Proposed Judgment threatens more harm to competition, and ultimately to consumers, than does the collusive conduct alleged in the Government's own complaint.

Apple is singled out in the Proposed Judgment and subject to uniquely punitive restrictions on its ability to negotiate agreements. Apple believes the allegations against it in the associated litigation are meritless.[2] Apple has done nothing wrong. It has refused to settle this case and looks forward to defending itself in court. But the Government is now seeking to punish Apple without due process, by proxy, before it has had its day in court. That is unfair and unjust. Apple should not be treated any differently than any other retailer in this Proposed Judgment.

The role of Amazon as protagonist in all of this is troubling. Amazon is by any measure or standard the industry monopolist, a dominant presence in the eBook and physical book marketplace. It routinely uses its leverage across both markets to impose its will on authors and publishers. That is undeniable. Amazon already is engaged in a course of conduct—including exclusivity arrangements, aggressive enforcement of MFNs, and threats of retaliation—to serve its interests and maintain its monopoly position. These tactics are well-recognized as having serious potential for consumer harm. Yet the Government stubbornly refuses to acknowledge Amazon's role in the market or its abusive conduct. In the Government's skewed sense of reality, Amazon is simply another retailer, not the 800-pound industry gorilla selling more than half of all the books in this country. As a result, the Government is now poised to restore and strengthen Amazon's stranglehold on this market.

The Proposed Judgment should be rejected or, at the very least, modified to reflect the allegations in the Complaint and ensure that eBook competition is preserved. The practical impact of the Proposed Judgment is an absolute prohibition of agency for at least two years. Sections V. and VI.B. cannot be read in any other way. These terms allow an eBook agent a nearly unfettered ability to discount a Settling Defendant's title. The discount is purportedly limited to an agent's aggregate commission for eBook sales over a given year, but that limit is meaningless because it decidedly favors the largest retailer, Amazon, which will have a greater ability to discount than will its rivals. The discount also will be impossible to monitor or administer. Amazon's ability to exploit the proposed structure, coupled with other nefarious Amazon tactics, will allow Amazon to recapture and retrench its monopoly position. Apple does

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[2] *See* Apple Inc.'s Answer, *United States v. Apple Inc., et al.*, Case No. 12-cv-02826 (DLC) (May 22, 2012), at 1 (ECF No. 54).

not believe that would be in the short term or long term interests of the American reader, writer, or publisher. The Government ignores that dangerous risk.

The market for eBooks is larger, more innovative, more dynamic, and more vibrant than it was before the shift to agency two years ago. The diversity of content, format, and device is much richer. For example, new categories such as cookbooks, children's books, and art books now are available digitally. The competition that has emerged since the shift to agency also has led to enhanced competition in e-reader devices. There can be no dispute about those facts. The Proposed Judgment's attack on agency puts the progress of the last two years at risk, as that competition was driven by entry and a business model that the Government seeks to severely restrict. The Government's move to regulate eBook competition may have dramatic and irreversible, if unintended, consequences.

The appropriate response to the Government's concern about collusion among the Settling Defendants would be to ensure that Amazon (or any other retailer) is free to negotiate contracts under any business model free from collusive coercion. For example, the Proposed Judgment could preclude the Settling Defendants from conditioning their commercial dealings with a retailer on that party's acceptance of the agency model or from engaging in any coordinated actions to discourage retailer choice. The answer cannot be the Government-contrived business model in the Proposed Judgment. The Government should not coerce third parties to abandon agency in favor of the Frankensteinian business model it has cobbled together. eBook retailers such as Apple and Barnes & Noble should be free to continue with the agency model without Government-mandated changes.

Sections IV.A., V.A., V.B., and VI.B. should be deleted entirely. Those terms are discriminatory and unfairly harsh on parties that are not subject to the Proposed Judgment. At a minimum, the Proposed Judgment should be modified in the following three ways:

- The Proposed Judgment should not require that the Settling Defendants terminate their agreements with only Apple. The agreements with Apple should be subject to the same terms and conditions, whatever they may be, as the Settling Defendants' agreements with all other retailers.

- Section VI.B of the Proposed Judgment should allow retailers to discount from their commissions on a per unit and not an aggregate basis. The current formulation destroys the agency model, is not administrable, and paves the way for the retailer with the largest overall commissions, Amazon, to drive out rivals with targeted predatory pricing tactics.

- Section VI.B. should allow a retailer to discount eBooks in an amount less than the entirety of its commission. The current formulation would allow Amazon to force other retailers to price below their costs in order to compete.

The Proposed Judgment is a mistake. It is incumbent on the Government to recognize its mistake and rectify it by modifying the terms of the Proposed Judgment before it is too late. As

written, the Proposed Judgment may serve the interests of the Settling Defendants and Amazon, but it will harm emerging eBook competitors such as Apple, Barnes & Noble, and other retailers, including independent retailers. In the end, the biggest loser will be the consumer, who will pay the price for retrenchment of the Amazon monopoly. Lower prices for a small handful of books that result from below-cost pricing may seem like a bargain in the short term, but they will enable Amazon to charge monopoly prices into perpetuity and limit innovation in the scope and functionality of eBooks, diminishing the reader experience. The harm would be irreversible and devastating. Simply put, the Proposed Judgment is not in the interests of competition or the public interest.

I. THE PROPOSED JUDGMENT DISPROPORTIONATELY AND UNFAIRLY HARMS THIRD PARTIES

Apple is unfairly singled out by the Proposed Judgment. The Settling Defendants agreed to terminate their agreements with Apple, and Apple alone, within seven days after the entry of the Proposed Judgment.[3] Every other retailer, including Amazon, is given time and choice. Apple is given neither. This is particularly unfair since Apple will suffer the consequences without first having the benefit of this Court's adjudication on the merits of the Government's allegations. The Government suggests that the immediate termination of Apple's agreements with the Settling Defendants "will permit the contractual relationships between Apple and the Settling Defendants to be reset subject to competitive constraints."[4] That is the full extent of the Government's explanation for its decision to terminate Apple's contracts with the Settling Defendants. But this ignores that Apple's existing agreements with the Settling Defendants were the subject of intense and difficult bilateral negotiations and were *the product* of intensely competitive constraints.

The Proposed Judgment modifies only two terms in Apple's agreements with the Settling Defendants—the MFN and Apple's pricing discretion under the agency agreement—but nevertheless requires termination of the agreements in their entirety.[5] Those changes do not justify ripping up Apple's agreements with these publishers. That certainly does not serve the interests of competition or consumers. Instead, it gives the Settling Defendants an opportunity to window digital content, to withhold digital content altogether, to negotiate higher retail price caps, to grant smaller commissions, and to seek to use their newfound, Government-created leverage to extract other commercial terms that are wholly unrelated to the Proposed Judgment and have nothing to do with the best interests of consumers. It also creates marketplace uncertainty.

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[3] *See* Proposed Judgment, *United States v. Apple Inc., et al.*, Case No. 12-cv-02826 (DLC) (Apr. 11, 2012), Section IV.A (ECF No. 4) ("Proposed Judgment").

[4] Competitive Impact Statement, *United States v. Apple Inc., et al.*, Case No. 12-cv-02826 (DLC) (Apr. 11, 2012), at 9–10 (ECF No. 5).

[5] Proposed Judgment at Sections V.B–C.

Apple will have to quickly negotiate new agreements with these publishers under a dark cloud of uncertainty in just seven days to ensure that it has operative distribution agreements with the Settling Defendants. This artificially-compressed time frame is not a foundation for a productive, long-term relationship. The Government has put a thumb on the scales on behalf of Amazon and the Settling Defendants. There is a risk that the Settling Defendants will refuse to negotiate commercially reasonable terms and simply pull their titles from the iBookstore. That would be flatly against the public interest. The negotiation of Apple's agreements with publishers should be driven by marketplace conditions and not by the terms of a Government-imposed decree.

There is no justification for singling out Apple consistent with due process. Apple's entry has brought a number of benefits. First, it brought much needed innovation. Apple introduced eBook consumers to new features, such as color pictures, audio and video, the read-and-listen functionality, and fixed-layout display, enabling readers to enjoy electronic versions of textbooks, cookbooks, travel books, magazines, and newspapers without sacrificing any of the graphics or content available in physical media. It was only after the release of the iPad that Barnes & Noble released a color version of its Nook and Amazon released the Kindle Fire. Second, Apple's entry has brought lower device prices. Amazon has lowered the price of the Kindle to respond to the iPad. Third, Apple's entry also has led to lower prices for many titles. Fourth, Apple's entry and increased competition led to increased output and selection, as Amazon, Apple, Barnes & Noble, and others aggressively expanded their catalogues. Fifth, Apple's entry enhanced consumer choice. Apple introduced a new and different audience to eBooks. It also encouraged greater consumer choice by promoting different eBooks than Amazon and Barnes & Noble, so a consumer visiting Apple's iBookstore will find distinctive titles featured. The value of this increased choice for consumers, authors, and publishers is significant. It has recently been reported that the market for eBooks is now larger in dollar terms than for physical books. That this dramatic expansion occurred after Apple's entry, which is now being challenged, is no coincidence. And the Proposed Judgment threatens all of this.

Apple is not alone in recognizing the peril to competition and consumers that would result from the Proposed Judgment. Far from it. New York Senator Charles Schumer has observed: "For the Antitrust Division to step in as the big protector of Amazon doesn't seem to make any sense from an antitrust point of view. Rarely have I seen a suit that so ill serves the interests of the consumer."[6] And a number of other third parties have voiced significant concerns about the impact that the Proposed Judgment will have on their business and livelihoods.[7] For example, Barnes & Noble has denounced the Proposed Judgment as "truly

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[6] Quoted in Peter Osnos, *Confused By the eBook Lawsuit? So Is Everyone else*, THE ATLANTIC, May1, 2012, *available at* http://www.theatlantic.com/business/archive/2012/05/confused-by-the-ebook-lawsuit-so-is-everyone-else/256581.

[7] *See, e.g.*, David Carr, *Book Publishing's Real Nemesis*, N.Y. TIMES, Apr. 15, 2012 at B1, *available at* http://www.nytimes.com/2012/04/16/business/media/amazon-low-prices-disguise-a-high-cost.html (noting that "Amazon has the Justice Department as an ally to rebuild its monopoly and wipe out other players" which will endanger "the interests of consumers" because "Amazon has used its market power to bully and dictate. [For example,] lean[ing] on the Independent Publishers Group in recent months for better terms and when those

unfortunate and misguided" and noted that the Government has "focused exclusively, and short-sightedly, on increased prices of *some* eBooks it has identified . . . to propose a settlement that threatens to destroy competition in this young thriving industry."[8] The Government has ignored the many concerns that have been loudly expressed to date. Nevertheless, there is still an opportunity to avoid a potentially devastating mistake.

II. THE PROPOSED JUDGMENT IS AN EXPERIMENT IN GOVERNMENT INTERVENTION

The Proposed Judgment is an ill-conceived experiment by the Government that ignores an important rule of law: the remedy must be directly related to the violations alleged in the Complaint. *United States v. SBC Commc'ns, Inc.*, 489 F. Supp. 2d 1, 17 (D.D.C. 2007). The crux of the Government's complaint is that the publishers forced adoption of the agency model *on Amazon* and that the change in business model resulted in competitive harm. It alleges that "over Amazon's objections, each Publisher Defendant had transformed its business relationship with all of the major e-book retailers from a wholesale model to an agency model . . ." and that the publishers had "locked themselves into forcing agency on Amazon to advance their conspiratorial goals."[9] The Government further alleges that "[a]s a direct result" of the publishers' "imposing agency agreements on all their . . . retailers[, those] retailers lost their ability to compete on price, including their ability to sell the most popular e-books for $9.99 or for other low prices."[10]

There is a tenuous connection, at best, between many of the terms in the Proposed Judgment and the Government's stated theory of concern. In some circumstances, there appears to be no connection at all. For example, the practical impact of the Proposed Judgment is an absolute prohibition of agency for at least two years. Sections V. and VI.B. cannot be read in any other way. These terms allow an eBook agent a nearly unfettered ability to discount a Settling Defendant's title. The Government's business model defies description, but it certainly cannot be described as agency. It is also impossible to identify the connection between these

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negotiations didn't work out, Amazon simply removed the company's almost 5,000 eBooks from its virtual shelves."); Mark Coker, *A dark day for the future of books*, CNN.COM, Apr. 15, 2012, *available at* http://www.cnn.com/2012/04/15/opinion/coker-book-publishing/index.html ("The government's intention to protect consumers could end up backfiring on consumers by harming retailers, authors[,] and publishers. It could inadvertently hasten the downfall of the world's largest book publishers by forcing them to comply with onerous conditions outlined in the Justice Department's Competitive Impact Statement. These conditions—including restrictions on collaboration with fellow publishers and increased federal auditing and reporting requirement—will increase publisher expenses and slow their business decisions at the very time when publishers need to become faster, nimbler competitors.")

[8] Barnes & Noble, Inc. Tunney Act Comment (June 7, 2012), at 4, 14, *available at* http://www.scribd.com/doc/96547823/United-States-v-Apple-Inc-et-al-Barnes-and-Noble-Complaint (emphasis in original).

[9] *See* Complaint, *United States v. Apple Inc., et al.*, Case No. 12-cv-02826 (DLC) (Apr. 11, 2012), at ¶¶ 79, 83 (ECF No. 1) ("Compl.").

[10] *Id.* at ¶ 8.

terms and the allegations in the Complaint. The Complaint alleges that the Settling Defendants conspired to force Amazon to sign agency contracts.[11] There is no suggestion that other retailers were forced into agency agreements. The industry as a whole, with the sole exception of Amazon, embraced the shift to agency. Indeed, the Government has stated that it is not challenging the agency model; nor could it. Yet Sections V. and VI.B. of the Proposed Judgment are a direct attack on the agency model.

Section VI.B. decidedly favors the largest retailer, Amazon, which will have a greater ability to discount than will its rivals. The discount purportedly is limited to an agent's aggregate commission for eBook sales over a given year, but that limit is meaningless because it will be impossible to monitor or administer, and it will allow Amazon to discount certain titles to zero. The business model imposed by the Government in the Proposed Judgment is artificial and contrived by decree, not by the marketplace. The Government's function is not and should not be to dictate business models, but if it persists in doing so through the decree, Section VI.B. should be modified to limit the discount *on a per unit basis*, which would be more administrable and would not decidedly favor the retailer that would have the largest aggregate annual commissions—Amazon. It also should be modified so that it does not put an agent in the position of having to price below its costs in order to compete with Amazon.

The Government does not allege that Apple's agency agreements with publishers themselves harmed competition. In fact, the shift to the agency model has resulted in increased innovation, competition, and increased consumer choice for eBooks. The Government should address the alleged harm rather than dictate business models; it should preclude the Settling Defendants from coercing any retailer to adopt agency. Such a remedy would more directly address the alleged harm. And any other relief would be unnecessary and counter-productive.

III. THE PROPOSED JUDGMENT WILL ENABLE THE RETRENCHMENT OF AMAZON'S E-BOOK MONOPOLY

Apple competes with a monopolist. That was not easy even before the Government decided to intervene and dictate the terms on which competition would take place. The combination of the Proposed Judgment and Amazon puts Apple, and every other eBook distributor, in peril. There is a real threat that Amazon will be able to retrench and extend its eBook monopoly. That would be terrible for consumers.

Amazon is the most powerful force in books. It accounts for 60% of eBook sales today. It also is the dominant retailer of physical books online with an estimated 70% share. It is estimated that Amazon will account for 50% of *all* book sales in 2012.[12] That makes Amazon an essential partner to any publisher, and, as a result, it has significant leverage to dictate terms in

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[11] *See* Compl. at ¶¶ 79-84.

[12] Stephen Windwalker, *Amazon Positioned for 50% Overall Market Share by End of 2012*, SEEKING ALPHA, Feb. 3, 2011, *available at* http://seekingalpha.com/article/250507-amazon-positioned-for-50-overall-market-share-by-end-of-2012.

its negotiations. And when publishers resist, Amazon makes them pay.[13] The alternative of an agency model helped level the playing field, but the Proposed Judgment threatens to undo that progress.

Amazon has engaged in a variety of tactics designed to maintain or exploit its dominant position. It has aggressively signed exclusive agreements with authors. It has boasted that over 10% of its eBook catalogue is exclusive to Amazon.[14] It also has negotiated broad MFNs that it ruthlessly has applied in an effort to discourage promotional activity on rival platforms.[15] Perhaps most alarmingly, Amazon has retaliated against publishers which desire to develop eBooks that take advantage of Apple's innovative platform. Apple's iPad and iBookstore allow publishers and authors to develop eBooks that are rich in functionality. Amazon's platform simply cannot offer the same depth and breadth in terms of features. Unable or unwilling to compete, Amazon uses its leverage and market position to discourage publishers from taking advantage of Apple's platform. This diminishes the reading experience for consumers and will have negative effects on the size of the market and the diversity of books available.

Section VI.B. allows retailers to discount each Settling Defendant's eBook titles up to the aggregate amount of annual commissions received from that Settling Defendant.[16] The discounting scheme in Section VI.B. disproportionately favors retailers with the largest eBook catalogues and the highest gross revenues from eBook sales. The larger a retailer's aggregate commissions, the deeper the discounts it can offer on the most popular titles. Amazon is far and away the largest retailer, and the two-year period of the Proposed Judgment is more than enough time for Amazon to re-establish its dominant position by returning to its practice of discounting to below-cost prices on the most popular titles. In fact, the two-year term provides Amazon with a stopwatch during which it must complete its mission. While the Government cannot stop Amazon if it chooses to resume its below-cost pricing, it should not actively facilitate such

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[13] Authors Guild, *The Right Battle at the Right Time*, Feb. 2, 2010, *available at* http://www.authorsguild.org/advocacy/articles/the-right-battle.html (noting that "Amazon has a well-deserved reputation for playing hardball," explaining how Amazon stopped selling Macmillan's titles after the publisher requested a shift to agency, and opining that Amazon's tactics "[are]n't good for those who care about books"); David Streitfeld, *Amazon Pulls Thousands of E-Books in Dispute*, N.Y. TIMES, Feb. 22, 2012, *available at* http://bits.blogs.nytimes.com/2012/02/22/amazon-pulls-thousands-of-e-books-in-dispute/?hpw (quoting Andy Ross, an agent, saying that independent publishers are "being offered a Hobson's choice of accepting Amazon's terms, which are unsustainable, or losing the ability to sell Kindle editions of their books, the format that constitutes about 60 percent of all e-books") (internal quotations omitted).

[14] Press Release, Amazon.com, Amazon.com Announces First Quarter Sales Up 34% to $13.18 Billion; 16 of the Top 100 Bestselling Titles Are Exclusive to the Kindle Store, (Apr. 26, 2012), *available at* http://www.businesswire.com/news/home/20120426006930/en/AMAZON.COM-ANNOUNCES-QUARTER-SALES-34-13.18-BILLION (quoting Jeff Bezos: "I'm excited to announces that we now have more than 130,000 new, in-copyright books that are exclusive to the Kindle store—you won't find them anywhere else. They include many of our bestsellers—in fact, 16 of our top 100 bestselling titles are exclusive to our store.")

[15] David Carr, *Navigating a Tightrope with Amazon*, N.Y. TIMES, Apr. 29, 2012, at B1, *available at* http://www.nytimes.com/2012/04/30/business/media/byliner-takes-buzz-bissingers-e-book-off-amazon.html.

[16] *See* Proposed Judgment, Section VI.B.

tactics. But this is precisely what the Proposed Judgment does. It provides Amazon with a two-year grace period during which it easily can re-establish its dominance—through predatory pricing. It is ironic that the Government, in the name of competition policy, seeks to put in place a regulatory judgment that could restore a monopoly.

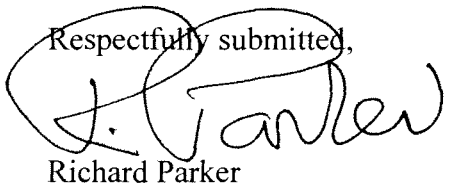
Amazon's scale and market share will give it a considerable competitive advantage under the Government's business model. Amazon will have a much greater ability strategically to price titles in its bookstore than will its competitors. The Proposed Judgment does not restrict how the discount may be applied across a retailer's catalogue. Amazon strategically could apportion its aggregate commission to force its rivals to price below their costs on the most popular books.

IV. CONCLUSION

The Proposed Judgment spells the end of the agency model and threatens to undo the huge strides and progress that have been made in the eBook industry in a relatively short period of time. The industry now features competitive prices, innovative products, consumer choice, and growing competition. The Proposed Judgment will stifle and perhaps eliminate innovation, reduce output, and decrease choice in an important cultural market. None of this serves the public interest.

Sections IV.A., V.A., V.B., and VI.B. are unwarranted and unsupported by the Government's stated concerns. The Government should impose a remedy that addresses the collusive conduct, if any, but does not impose or restrict any particular business model. Because the Government alleges that antitrust harm resulted from the publishers' collusive efforts to force agency on Amazon, the proposed remedy should prevent the *publishers* from conditioning their business dealings *with Amazon* on adoption of the agency model.

Respectfully submitted,



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