UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

UNITED STATES OF AMERICA, **Plaintiff,** **v.** **APPLE, INC., et al.** **Defendants.**	Civil Action No. 1:12-CV-2826

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NATIONAL ASSOCIATION OF COLLEGE STORES' COMMENTS CONCERNING THE PROPOSED E-BOOK FINAL JUDGMENT

The Proposed Final Judgment reaches entirely beyond the conspiracy and market alleged in the Complaint and thus requires modification before it can be approved. While the Complaint focuses solely on the market for trade e-books and expressly excludes from its scope other, non-trade markets, such as the e-textbook market, the Proposed Final Judgment would apply to *all* e-books. This will cripple innovation and competition in non-trade e-book markets. Moreover, this overreach is flatly barred by the Tunney Act. The National Association of College Stores ("NACS") therefore submits these comments to encourage the parties and this Court to narrow the scope of the Final Judgment, clarify its scope, and avoid unnecessarily damaging markets outside of the scope of the Complaint.

I. PRELIMINARY STATEMENT

A. The National Association of College Stores is Expert in the Textbook Market.

NACS is a not-for-profit trade association headquartered in Oberlin, Ohio. NACS represents the $10 billion campus retailing industry. More than 3,000 stores serving colleges, universities, and K-12 schools in the United States, Canada, and around the world are members of NACS, along with more than 1,000 companies supplying goods and services to campus stores. NACS members also include higher education professionals, organizations, associations, and others interested in the industry's vitality. NACS members account for the majority of textbook sales in the United States, and more than half of NACS members' net sales are in the textbook market.

B. The Market for *Trade* e-Books is Distinct From the Market for e-*Textbooks*.

The e-book market is growing rapidly, with e-books representing upwards of 20% of book sales in the United States. But the e-book market consists of distinct sub-markets with differing growth trajectories. In particular, trade e-books account for the vast majority of e-book sales. By contrast, the market for e-textbooks has developed much more slowly than the market for trade e-books. Very few students, schools, or other buyers currently purchase e-textbooks, with e-textbooks accounting for less than 5% of textbook sales. Demand for e-textbooks is limited by many purchasing factors unique to the textbook market. For example, university faculty often must approve course materials, including whether students may use an e-textbook version of the course book. Students report that old-fashioned annotation and highlighting are integral to their studies and cannot – yet – be adequately replicated with e-textbooks. Also, hardcopy rental and buy-back programs create financial incentives for students to choose textbooks over e-textbooks. As the technology evolves, however, the utility of e-textbooks will

expand, and market demand is predicted to follow. No one can accurately predict the pace of the market's expansion. But new developments, such as Microsoft's recent investment in Barnes & Noble's e-book and textbook divisions, are expected to propel the market in new directions, particularly over the next several years.

C. The Facts in this Case Rest Entirely Within the Trade Market.

The government alleges in its Complaint that seven book publishers conspired with Apple to collectively move from a wholesale model to an agency model for the sales of their trade e-books. *See generally* Compl. ¶¶ 37-93. The resulting agency agreements allegedly controlled prices and caused consumers to pay higher prices for trade e-books. *Id.* ¶¶ 5-7, 76-77, 84, 90-93, 97.

The Complaint expressly excludes from its allegations the non-trade e-book market. The Complaint provides that "the relevant product market for purposes of this action is trade e-books," defining "trade e-books" to mean "general interest fiction and non-fiction books." Compl. ¶¶ 27, 99. The Complaint then goes further, recognizing the clear distinction between the trade e-book market and the *non*-trade e-book market:

> Non-trade e-books include electronic versions of children's picture books and academic textbooks, reference materials, and other specialized texts that typically are published by separate imprints from trade books, often are sold through separate channels, and are not reasonably substitutable for trade e-books.

Compl. ¶ 27 n.1. The two markets are so distinct that the government goes out of its way to exclude non-trade e-books from its allegations, admitting that non-trade e-books are "not reasonably substitutable for trade e-books," operate on an entirely different pricing model, are "sold through separate channels," and have separate publisher-retailer agreements. *Id.*

After excluding the non-trade e-book market from the Complaint's articulation of the relevant market, the Complaint goes on to focus solely on the anticompetitive behavior in the trade e-book market. The Complaint alleges that "the anticompetitive acts at issue in this case directly affect the sale of trade e-books to consumers," and that "the Publisher Defendants were able to impose and sustain a significant retail price increase for their trade e-books." *Id.* at ¶ 99 (emphasis added). The government's specific alleged violations further relate only to trade e-books. *Id.* at ¶ 101 ("The Publisher Defendants possess market power in the market for trade e-books [and] successfully imposed and sustained a significant retail price increase for their trade e-books."); *id.* at ¶ 101 ("Collectively, the [Publisher Defendants] provide a critical input to any firm selling trade e-books to consumers. Any retailer selling trade e-books to consumers would not be able to forgo profitably the sale of the Publisher Defendants' e-books."); *id.* at ¶ 102 ("Defendants' agreement and conspiracy has had and will continue to have anticompetitive effects, including: Increasing the retail prices of trade e-books . . . . ") (emphasis added). The Complaint therefore alleges anticompetitive behavior only in the trade e-books market.

II. THE PROPOSED FINAL JUDGMENT REQUIRES CAREFUL SCRUTINY.

The Proposed Final Judgment would impose far-reaching changes, nullifying existing agency agreements and preventing publishers from entering into similar agreements with *any* e-book retailer. Proposal §§ III-VI. When assessing the Proposed Final Judgment, the Court's review cannot be "an overly deferential review of prosecutors' judgments," but must be an entirely "independent judgment." *See United States v. SBC Commc'n, Inc.*, 489 F. Supp. 2d 1, 11-12 (D.D.C. 2007) (discussing legislative history of 2004 Amendments). Most importantly, the judgment must be "in the public interest." 15 U.S.C. § 16(e)(1); *United States v. Keyspan Corp.*, 763 F. Supp. 2d 633, 637 (S.D.N.Y. 2011); *United States v. Microsoft Corp.*, 56 F.3d

1448, 1462 (D.C. Cir. 1995). To achieve this end, the Antitrust Procedures and Penalties Act (the "Tunney Act") requires consideration of, among other things:

> (A) the competitive impact of such judgment, including . . . whether its terms are ambiguous, and any other competitive considerations bearing upon the adequacy of such judgment that the court deems necessary to a determination of whether the consent judgment is in the public interest; and
>
> (B) the impact of entry of such judgment upon competition in the relevant market or markets . . . .

15 U.S.C. § 16(e)(1). Specifically, the Court must consider "the relationship between the remedy secured and the specific allegations set forth in the government's complaint, whether the decree is sufficiently clear . . . and whether the decree may positively harm third parties." *United States v. Graftech Int'l Ltd.*, 1:10-CV-02039-RMC, 2011 WL 1566781, at *12 (D.D.C. Mar. 24, 2011).

III. THE PROPOSED FINAL JUDGMENT MUST BE REVISED.

The allegations in the Complaint address facts related to the *trade* e-book market only, while the Proposed Final Judgment encompasses *all* e-books. This disconnect represents a substantial overreach, and the Proposed Final Judgment must be amended.

A. The Proposed Remedies Far Exceed the Scope of the Complaint.

The remedies set forth in the decree must directly relate to the allegations in the complaint, otherwise the judgment "fall[s] outside of the reaches of the public interest." *Microsoft*, 56 F.3d at 1461. While the settlement need not "perfectly remedy the alleged antitrust harms," the government must at least provide a "factual foundation for [its] decisions such that its conclusions regarding the proposed settlement are reasonable." *Graftech*, 2011 WL 1566781, at *17. In essence, the Court may not "enjoin all future illegal conduct of the defendant, or even all future violations of the antitrust laws," regardless of what is alleged in the complaint.

Zenith Radio Corp. v. Hazeltine Research, Inc., 395 U.S. 100, 133 (1969). Rather, the Court must ensure that the remedy is "tailored to fit the wrong creating the occasion for the remedy." *New York v. Microsoft Corp.*, 224 F. Supp. 2d 76, 100 (D.D.C. 2002) *aff'd,* 373 F.3d 1199 (D.C. Cir. 2004) (quoting *U.S. v. Microsoft Corp.,* 253 F.3d 34, 107 (D.C. Cir. 2001)). The decree is therefore bound by the four corners of the complaint. *See* 15 U.S.C.A. § 16(e)(1)(B); *Microsoft*, 56 F.3d at 1459; *Keyspan*, 763 F. Supp. 2d at 638.

Consequently, antitrust consent decrees may not extend beyond the bounds of the allegations and markets alleged in a complaint. For example, in the legendary AT&T dissolution case, the proposed consent decree required AT&T to divest itself of its operating companies that provided local telephone service throughout the country and assigned each one to a specific geographic area. *United States v. Am. Tel. & Tel. Co.*, 552 F. Supp. 131, 141-42 (D.D.C. 1982) *aff'd Maryland v. United States*, 460 U.S. 1001 (1983). The proposed decree went even further, however. The government proposed myriad restrictions on the spun-off operating companies, including prohibiting the companies from manufacturing certain products and conducting particular marketing and advertising programs. *Id.* at 143, 186.

Upon review, the *AT&T* court carefully scrutinized the proposed restrictions to ensure that they did "not actually limit competition by unnecessarily barring a competitor from a market." *Id.* at 186. The court noted that to "unquestioningly 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 . . . would be to revert to the 'rubber stamp' role" that the Tunney Act eliminated. *Id.* at 151. The court determined that the restrictions went too far in regulating conduct beyond the scope of the complaint. In particular, the court concluded that the restriction on new areas of business were "directly anticompetitive because they prevent[ed] a

potential competitor from entering the market," and if the operating companies were allowed to participate, they would likely "promote a genuinely competitive market." *Id.* at 187, 192. The court also held that the marketing prohibitions were not in the public interest because they restricted pro-competitive activity. *Id.* at 192-93. Thus, the court required revision of the proposed decree to eliminate the problematic prohibitions. *Id.*

The court in *U.S. v. SBC Communications* addressed the inverse of this principle when it reviewed the proposed judgments in the antitrust action related to the SBC-AT&T and Verizon-MCI mergers. *SBC Comm's*, 489 F. Supp. at 3-4. There, the *amici curiae* argued that the proposed judgments were insufficient because they did not address other similar markets affected by the proposed mergers and "fail[ed] to remedy competitive harms in markets for other products that indirectly" related to the relevant products in the complaint. *Id.* at 22. The court responded that it could only consider whether the decree addressed the "markets implicated by the government's complaint," and that any remedies addressing markets outside the complaint are improper. *Id.* at 14, 22-23 (citing 15 U.S.C. § 16(e)(1)). Because "the complaints are clearly and explicitly limited" to the relevant market, the proposed additions went impermissibly "beyond the scope of the complaints." *Id.* at 22-23.

Here, the proposed remedies apply to the entire e-book universe and thus are not appropriately tailored to the facts in the Complaint. As discussed above, the government's allegations pertain only to the trade e-book market, expressly excluding the e-textbook and other non-trade e-book markets. Compl. ¶ 27 n.1. The Competitive Impact Statement further confirms that the government is focused solely on the trade e-book market. In describing the market at issue, and the effects of the alleged illegal agreement, the government represents that the

competitive impact will *solely* reach the trade e-book market. *See* Competitive Impact Stmt. §§ II.A, II.B (discussing market share of trade e-books).

By contrast, the Proposed Final Judgment fails to narrowly focus on the trade e-book market and, instead, would apply to the sale of all e-books, including e-textbooks. Proposal § II.D (defining "E-books" to mean "an electronically formatted book designed to be read on a computer, a handheld device, or other electronic devices capable of visually displaying E-books.").[1] The Proposed Final Judgment thus does not provide a "factual basis for concluding that the settlements are reasonably adequate remedies for the alleged harms," *see SBC Commn's*, 489 F. Supp. 2d at 17, and the proposed remedy is not specifically tailored to the allegations in the Complaint, *see Microsoft,* 253 F.3d at 107. By its express terms, there are no facts in the Complaint that could apply to non-trade e-books; the decree thus "fall[s] outside of the reaches of the public interest," and cannot be approved as written. *See Microsoft*, 56 F.3d at 1461.

B. The Proposed Final Judgment Also Will Impermissibly Harm Third Parties.

A judgment that injures third parties must be modified. 15 U.S.C. § 16(e)(1)-(2); *United States v. Thomson Corp.*, 949 F. Supp. 907, 929-30 (D.D.C. 1996) (denying consent decree and directing parties to submit revisions to avoid injuries to third parties); *Microsoft*, 56 F.3d at 1462. For instance, in the antitrust suit stemming from The Thomson Corporation's acquisition of West Publishing Company, numerous third parties contended that they would be harmed by a licensing fee provision in the proposed judgment that would shift certain costs to small publishers. *Thomson Corp.*, 949 F. Supp. at 925, 928-30. The court held that due to the harm the provision caused to third parties, as well as the provision's inability to "remedy the anticompetitive effects of the merger alleged in the complaint," the proposed judgment was not a sufficient remedy for

[1] The Proposed Final Judgment provides that "E-books" do not include (1) audio books; (2) standalone specialized software applications ("apps"); or (3) media files containing an electronically formatted books. *Id.* This does not exclude in any way non-trade e-books, which would therefore be included in the Proposed Final Judgment.

the allegations in the complaint, was "beyond the reaches of the public interest," and had to be modified. *Id.* at 929-31.

Here, if the Proposed Final Judgment is not amended to exclude the non-trade e-book market, the remedy will significantly harm third parties competing in other, non-targeted markets, including NACS members and other textbook and reference book retailers. Under the proposal, the settling defendants *as well as* any other entity involved in the sale of e-books are barred from various conduct related to the sale of e-books, including e-textbooks. *See* Proposal § II.L (those "Persons" subject to the proposal include non-defendants) and § III (those regulated by the proposal include all entities that "participated" with any of the settling defendants). Accordingly, all e-book retailers in the trade and non-trade e-book markets would, in effect, be punished for the defendants' alleged wrongdoing. These third-parties would be subject to the proposal's restrictions, including:

- Prohibitions on entering into new agreements that restrain price, § V.B;
- Prohibitions on entering into new agreements using an agency model, §§ VI.B, V.C; and
- Government review of new agreements, § IV.D.

These restrictions would affect all e-book retailers and prevent them from freely competing in markets that, by the Complaint's express terms, are entirely unrelated to the conduct at issue.

The Proposed Final Judgment would also prohibit textbook publishers and retailers from exploring the agency model. While publishers have not yet tested an agency model in the textbook market, textbook publishers and retailers should retain the flexibility to do so in the future. A competitive market must permit its participants to freely enter into new and creative business arrangements. The agency model could preserve long-term competitiveness in the distribution marketplace and help maintain competitive pricing, but the Proposed Final Judgment

would bar market participants from reaping these pro-competitive benefits. It is not in the public interest to punish the textbook market based on the alleged misuse of the agency model in the entirely separate trade market. Moreover, there is nothing in the Complaint, nor could there be, to allege that an agency model is itself illegal or that it should not be freely explored in markets not implicated by the government's allegations. *See, e.g.*, *U.S. v. General Electric Co.*, 272 U.S. 476 (1926) (agency model comports with the antitrust laws).

Furthermore, the government failed to consider the impact of the proposal on the textbook market in the Competitive Impact Statement. The Competitive Impact Statement must address the proposed remedy's "anticipated effects on competition" to enable the Court to consider how the judgment will affect the market. 15 U.S.C. §§ 16(b)(3), 16(e)(1)(A). The Competitive Impact Statement explains that the alleged collusive conduct has "prevented e-book retailers from experimenting with innovative pricing strategies that could efficiently respond to consumer demand." Competitive Impact Stmt. § II.C. Yet, the government does not address how eliminating the viability of the agency model beyond the trade e-book market will hinder non-trade e-book retailers from experimenting with different sales models, a clear effect on competition resulting from the Proposed Final Judgment.

Exacerbating the impact on the e-textbook market is the predictable and harmful result the Proposed Final Judgment will have in furthering Amazon's market power. The government acknowledges in its Complaint that Amazon was the e-book market leader prior to the introduction of the agency pricing model. *See* Compl. ¶¶ 30-31 (describing the publisher defendants' inability to meaningfully compete with Amazon's $9.99 trade e-book prices). Indeed, in the trade e-book market, "before 2010, there was no real competition, there was only Amazon. . . . Amazon sold nearly nine out of every ten eBooks, and its power over price and

product selection was nearly absolute." Apple Inc. Answer at 1 [Dkt. No. 54]. This was driven in part by Amazon's practice of selling e-books below cost. *See* Compl. ¶ 30 (Amazon "offered newly released and bestselling e-books to consumers for . . . less than the wholesale price of the hardcover versions of the same titles"); Penguin Answer at 2 [Dkt. No. 57]; MacMillan Answer at 3 [Dkt. No. 59] ("Charging below wholesale prices, Amazon erected impenetrable barriers to entry to meaningful competition in eBook distribution, thus protecting its more than 90% share of the business.").

Amazon injects the same practices into the textbook market. For the last several years, Amazon has routinely sold thousands of the top-selling textbook titles at prices below the cost at which NACS members can purchase the same titles from publishers. NACS members are losing sales to Amazon's below-cost pricing. If the proposed judgment is not modified, Amazon will similarly prey on the e-textbook market. The Proposed Final Judgment, as written, will predictably allow Amazon to continue to carry out its predatory and monolithic business practices in the textbook market.

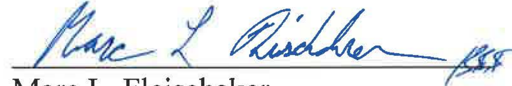
IV. CONCLUSION

Whether the Proposed Final Judgment includes the non-trade e-book market as the result of purposeful drafting, mistake, or ambiguity, it must be narrowed to apply only to the relevant, trade market. The parties and the Court are obligated to clarify an otherwise unmanageable proposed judgment. *SBC Comm's*, 489 F. Supp. 2d at 17; *Thomson*, 949 F. Supp. at 916-17 (D.D.C. 1996) (in response to public comments, the parties agreed to incorporate language into the final judgment to "remove any doubt" about the impact of the remedy, and the court approved the revision); *Microsoft*, 56 F.3d at 1462. ("If the decree is ambiguous . . . we would expect the court to insist that these matters be attended to[.]"). For the Final Judgment to comply

with the Tunney Act, it must explicitly differentiate between trade and non-trade e-books and state that the remedy applies only to the former. The definition for "E-books" must indicate that certain categories of e-books, particularly non-trade e-books (including textbooks), are excluded from the Final Judgment.

Dated: June 19, 2012

Respectfully Submitted,



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