THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

UNITED STATES OF AMERICA
United States Department of Justice, Antitrust Division
600 E Street, NW, Suite 9500
Washington, D.C. 20530,

Plaintiff,

v.

CENGAGE LEARNING HOLDINGS I, L.P.,
CENGAGE LEARNING HOLDINGS II L.P.,
CENGAGE LEARNING, INC.,
APAX/TL HOLDINGS, LLC,
EDUCATION MEDIA AND PUBLISHING GROUP LIMITED, and
HOUGHTON MIFFLIN HARCOURT PUBLISHING COMPANY,

Defendants.

CASE NO.:

JUDGE:

Case: 1:08-cv-00899
Assigned To : Bates, John D.
Assign. Date : 5/28/2008
Description: Antitrust

COMPLAINT

The United States of America, acting under the direction of the Attorney General of the United States, brings this civil antitrust action to enjoin the proposed acquisition by Cengage Learning, Inc. and related entities (collectively "Cengage"), of the assets of the Houghton Mifflin College Division ("HM College") from Houghton Mifflin Harcourt Publishing Company and a related entity (collectively "Houghton Mifflin"), and to obtain equitable and other relief. The United States complains and alleges as follows:

I. NATURE OF THE ACTION

1. On or about November 30, 2007, Cengage and Houghton Mifflin entered into an agreement for Cengage to acquire the assets of HM College for approximately $750 million.

2. Cengage and HM College publish textbooks and other educational materials and

are direct competitors in the development, publication, and sale of textbooks and ancillary print and electronic (including Internet-based) educational materials (collectively "textbooks and ancillary materials") used in numerous courses taught at higher education institutions throughout the United States. For the courses listed in Appendix A of this Complaint (hereinafter "the Overlap Courses"), Cengage and HM College publish textbooks and ancillary materials that compete head-to-head with each other and are close substitutes.

3. The markets for textbooks and ancillary materials used in the Overlap Courses are highly concentrated and have high barriers to entry. Cengage's proposed acquisition of the assets of HM College would eliminate competition between Cengage and HM College in these markets.

4. The United States brings this action to prevent Cengage's proposed acquisition of the assets of HM College because it is likely to substantially lessen competition in the development, publication, and sale of textbooks and ancillary materials used in the Overlap Courses in violation of Section 7 of the Clayton Act, 15 U.S.C. § 18.

II. PARTIES TO THE PROPOSED ACQUISITION

5. Cengage Learning, Inc. is a Delaware corporation with its headquarters in Stamford, Connecticut. Cengage Learning Holdings I, L.P., a limited partnership with its headquarters in Stamford, Connecticut, is the ultimate parent entity of Cengage Learning, Inc. Cengage Learning Holdings II L.P., a limited partnership with its headquarters in Stamford Connecticut, is an intermediate entity between Cengage Learning Holdings I, L.P. and Cengage Learning, Inc. Apax/TL Holdings, LLC, a Delaware limited liability company, is the general partner in Cengage Learning Holdings I, L.P. The above entities (collectively "Cengage") develop, publish, and sell textbooks and ancillary materials for use in the United States and elsewhere. Cengage is the second largest publisher of textbooks and ancillary materials used in

courses taught at higher education institutions in the United States and ranks among the top three sellers of such textbooks and materials for each of the Overlap Courses. Cengage had total revenues of about $1.7 billion in the twelve-month period ending September 30, 2007, including about $1 billion in revenues from the sale of higher education textbooks and ancillary materials.

6. Houghton Mifflin Harcourt Publishing Company (formerly Houghton Mifflin Company) is a Massachusetts corporation with its headquarters in Boston, Massachusetts. Education Media and Publishing Group Limited, a Cayman Islands corporation with its headquarters in Dublin, Ireland, is the ultimate parent entity of Houghton Mifflin Harcourt Publishing Company. The above entities (collectively "Houghton Mifflin") develop, publish, and sell textbooks and ancillary materials for use in the United States and elsewhere. Houghton Mifflin's HM College Division is the fifth largest publisher of textbooks and ancillary materials used in courses taught at higher education institutions in the United States and ranks among the top three sellers of such textbooks and materials for each of the Overlap Courses. Houghton Mifflin has total annual revenues of about $2.5 billion, and estimated 2007 revenues of about $230 million from the sale of textbooks and ancillary materials by HM College.

III. JURISDICTION AND VENUE

7. The United States brings this action under Section 15 of the Clayton Act, as amended, 15 U.S.C. § 25, to prevent and restrain the Defendants from violating Section 7 of the Clayton Act, 15 U.S.C. § 18.

8. Defendants' activities in developing, publishing, and selling textbooks and ancillary materials for use in the Overlap Courses are in the flow of and substantially affect interstate trade and commerce. This Court has subject matter jurisdiction over this action

pursuant to Section 12 of the Clayton Act, 15 U.S.C. § 22, and 28 U.S.C. §§ 1331, 1337(a), and 1345.

9. Defendants sell higher education textbooks and ancillary materials in, and have consented to venue and personal jurisdiction in, this judicial district. Venue is proper under 15 U.S.C. § 22 and 28 U.S.C. § 1391(d).

IV. TRADE AND COMMERCE

A. Relevant Product Markets for Textbooks and Ancillary Materials

10. Publishers market and sell textbooks and ancillary materials for use in courses taught at higher education institutions. In most cases, instructors select the textbooks and ancillary materials that will be used for their courses, and students buy the selected textbooks and ancillary materials.

11. Textbooks are often supplemented with ancillary educational materials, such as teacher's editions, audio-visual teaching tools, Internet content, CD-ROMs, workbooks, and study guides. These materials are often offered by publishers for free or as part of a discounted package to induce instructors to select a particular textbook and to induce students to purchase the publisher's textbooks and ancillary materials.

12. Textbooks and ancillary materials are used as the primary teaching materials in each of the Overlap Courses. Textbooks provide the core written material for the Overlap Courses and serve as the foundation for instructors' overall lesson plans. While instructors could use alternative teaching materials (such as copies of lecture notes and articles), they generally select textbooks to serve as the primary teaching materials for their courses because accessing and creating alternative teaching materials is often a more time-consuming, costly, and inefficient method of delivering high quality content to their students. Instructors using textbooks and

ancillary materials would not turn to any alternative teaching materials in sufficient numbers to defeat a small but significant increase in the price of any textbooks and ancillary materials for the Overlap Courses, or a small but significant decrease in the quality of such textbooks and other materials.

13. Students taking the Overlap Courses are unlikely to have any significant alternatives to purchasing new textbooks for these courses. Although used textbooks, if available, can sometimes serve as alternatives for new textbooks, used textbooks are not uniformly available in large numbers. Moreover, instructors often require students to use the newest textbook editions. Publishers generally revise textbooks every three to four years and revised textbooks often differ substantially from their prior edition, limiting the extent to which used textbooks may be substituted for new editions of the same textbooks. Students would not turn to purchasing used textbooks in sufficient numbers to defeat a small but significant increase in the price of a new edition of the textbooks.

14. Each Overlap Course is a separate course focused on a different subject and therefore requires instructors and students in the course to use the textbooks and ancillary materials that have been developed for that course. For each Overlap Course, the textbooks and ancillary materials for that course constitute a separate relevant product market and a line of commerce pursuant to Section 7 of the Clayton Act.

B. The Relevant Geographic Market

15. Defendants market and sell textbooks and ancillary materials for use in courses taught at higher education institutions throughout the United States. Market participants for each relevant product market alleged herein are those publishers from which instructors select textbooks and ancillary materials for use as primary teaching materials in their courses. A

hypothetical monopolist of the textbooks and ancillary materials sold for use in any Overlap Course in the United States could profitably lower the rate of quality improvements in and/or increase the price of such textbooks and ancillary materials in the United States. For each relevant product market alleged herein, the United States constitutes a relevant geographic market pursuant to Section 7 of the Clayton Act.

C. Anticompetitive Effects: Loss of Price and Product Quality Competition

16. In each relevant product and geographic market alleged herein, Cengage and HM College offer leading textbooks and ancillary materials that are close substitutes for a significant number of customers in that market. In each such market, Cengage and HM College are among the few firms with a significant presence that compete to provide textbooks and ancillary materials and consistently account for at least 35 percent of all sales. Using a standard concentration measure called the Herfindahl-Hirschman Index (or "HHI," defined and explained in Appendix B), the proposed acquisition would substantially raise market concentration in highly concentrated markets, increasing the HHI by more than 500 and producing a post-merger HHI in excess of 3000 in each relevant market.

17. Cengage and HM College compete head-to-head to be selected by instructors to provide textbooks and ancillary materials for each Overlap Course in the United States. This competition has provided significant incentives for each to publish new titles and improve product quality and has disciplined pricing decisions. The proposed acquisition would eliminate this competition in each relevant market, increasing the likelihood that Cengage will unilaterally increase prices or reduce its investment or other efforts to develop new or improved textbooks and ancillary materials.

18. The proposed acquisition is likely to substantially lessen competition in the development, publication, and sale of textbooks and ancillary materials in each of the relevant markets, in violation of Section 7 of the Clayton Act.

D. Entry: New Entrants Will Not Defeat an Exercise of Market Power

19. In each relevant product and geographic market alleged herein, there is unlikely to be timely entry by any firm that would be sufficient to defeat the likely anticompetitive effects of the proposed acquisition. Successful entry into developing, publishing, and selling textbooks and ancillary materials in each of the relevant markets is difficult, time-consuming, and costly.

20. Successful entry generally can be achieved only over many years and after at least one or more textbook revision cycles. Significant investment and effort are required to assemble authors, editorial staff, and reviewing professors, to develop and obtain licenses to copyrighted content and ancillary educational materials, and to train a knowledgeable sales force. The outcome of such effort would be highly uncertain because, among other things, the reputation of a successful incumbent textbook is difficult for a publisher of a new textbook to challenge. The leading textbooks in each relevant market have been published for some time and are well-known to instructors. Most instructors switch textbooks infrequently because they develop course syllabi, lesson plans, homework, tests, and other materials that conform to the textbooks they use, and changing textbooks usually requires modifications to course syllabi and other materials.

V. VIOLATIONS ALLEGED

21. The United States incorporates the allegations of paragraphs 1 through 20 above.

22. The proposed acquisition of HM College by Cengage would substantially lessen competition in interstate trade and commerce in violation of Section 7 of the Clayton Act, 15 U.S.C. § 18.

23. Unless restrained, the acquisition would likely have the following anticompetitive effects, among others:

a. actual and future competition between Cengage and Houghton Mifflin in the development, publication, and sale of textbooks and ancillary materials in each relevant product and geographic market alleged herein will be eliminated;

b. competition in the development, publication, and sale of textbooks and ancillary materials in each relevant market will be substantially lessened; and

c. the rate of quality improvements in the textbooks and ancillary materials in each relevant market likely will decline and/or prices for such textbooks and ancillary materials likely will increase.

VI. **REQUEST FOR RELIEF**

24. The United States requests that this Court:

a. adjudge and decree the proposed acquisition to violate Section 7 of the Clayton Act, 15 U.S.C. § 18;

b. enjoin and restrain the Defendants and all persons acting on their behalf from consummating the proposed acquisition or from entering into or carrying out any contract, agreement, plan, or understanding, the effect of which would be to combine HM College with the operations of Cengage;

c. award the United States its costs for this action; and

d. grant the United States such other and further relief as the Court deems just and proper.

Respectfully submitted,

FOR PLAINTIFF UNITED STATES OF AMERICA:

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Dated: May 28, 2008

APPENDIX A

Overlap Courses

Business: Introductory

Foreign Languages and Literature: French: Language: Business French

Foreign Languages and Literature: French: Language: Intermediate

Foreign Languages and Literature: German: Language: Grammar

Foreign Languages and Literature: Italian: Language: Elementary

Foreign Languages and Literature: Italian: Language: Intermediate

History: Western Civilization Survey: 1500 to Present

History: Western Civilization Survey: 1750 to Present

History: Western Civilization Survey: Prehistory to 1715

History: Western Civilization Survey: Prehistory to Present

History: World History Survey: 1400 to 1750

History: World History Survey: 1500 to Present

History: World History Survey: Prehistory to Present

Interdisciplinary Studies: Orientation to College

APPENDIX B

Herfindahl-Hirschman Index

"HHI" means the Herfindahl-Hirschman Index, a commonly accepted measure of market concentration. It is calculated by squaring the market share of each firm competing in the market and then summing the resulting numbers. For example, for a market consisting of four firms with shares of 30%, 30%, 20%, and 20%, the HHI is 2600 (302 + 302 +202 + 202 = 2600). The HHI takes into account the relative size distribution of the firms in a market and approaches zero when a market consists of a large number of small firms. The HHI increases both as the number of firms in the market decreases and as the disparity in size between those firms increases.

Markets in which the HHI is between 1000 and 1800 points are considered to be moderately concentrated, and those in which the HHI is in excess of 1800 points are considered to be highly concentrated. *See Horizontal Merger Guidelines* ¶ 1.51 (revised Apr. 8, 1997). Transactions that increase the HHI by more than 100 points in concentrated markets presumptively raise antitrust concerns under the guidelines issued by the U.S. Department of Justice and Federal Trade Commission. *See id.*