

The Idea Logical Company, Inc.

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LITIGATION III, ANTITRUST DIV.
U.S. DEPT OF JUSTICE

Dear Mr. Read,

I am submitting by way of this letter two concerns that I hope will be taken into account concerning the DoJ's complaint against Apple and five publishers, as well as the settlement agreements negotiated and now being considered by the Court.

One concern is the danger of introducing an enormous imbalance to the publishing business, which will ultimately hurt all authors and readers, through the Government's apparent rejection of the idea of uniform pricing of the sale of individual ebooks across all Internet retail sites.

The other pertains specifically to the settlement agreement, in particular the need for detailed consideration of how one of its central operative provisions will be enforced and executed, which I believe is not reflected in the documents filed so far.

I have read Judge Cote's decision dated May 15, 2012, which was a powerful impetus to me to write this letter. I was deeply impressed with the evident care she took in reviewing the parties' submissions. But I also feel that the decision was at least partly based on profoundly incorrect premises that I can only conclude arose out of a failure of the parties to convey important realities that are characteristic of the book publishing industry.

I do not pretend to have information on the alleged facts of collusion or any expertise on the law regarding collusion or antitrust. My expertise is in the book business, and particularly in how digital change affects it. I offer the thoughts set out below as a publishing consultant (and also as an author) with 50 years of experience in all aspects of the book business. My first real summer job was in a major bookstore in 1962. My father was in the industry before me. I have spent the last 20 years largely immersed in the industry's transition to digital media, speaking at and

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organizing numerous conferences throughout that time on this subject. The primary focus of my work is to help the different players in the publishing industry figure out where today's developments will lead us tomorrow. I hope the DoJ and the Court will value these thoughts as coming from somebody who has given them in-depth consideration for many years.

My first concern is that there is a failure of recognition of the necessity for price-setting of individual titles across the ebook supply chain. Indeed, only by eliminating price as a basis of competition can we have any ultimately have balanced competition in the real world of publishing as digital change has remade it.

And, in fact, that reality has been demonstrated by the shifts in market share that have taken place since agency pricing was introduced. There is a far more diverse ebook ecosystem now, offering far more purchasing choices for consumers, than there was before agency. And there has been innovation, specifically Barnes & Noble's introduction of Nook devices that have delivered previously unavailable features, that also would have been less likely without agency pricing.

Before ebooks, retail booksellers needed publishers to provide them with product to sell, and publishers needed booksellers to give publishers orderly access to the buying public. That was true when Amazon began as a print book retailer in 1995. At the time it began, the only way to be a successful book retailer online was to supply titles across all publishers. When the idea of purchasing books online was new and the number of people to whom it was available was far smaller than it is today, only a source with the full range of choice could attract a substantial customer base.

In the years before ebooks became commercially important, Amazon established a dominant position in the online retailing of books, and in doing so it also created a huge database of book-purchasing customers. This helped Amazon considerably to become the most influential force in jump-starting the ebook revolution, starting with the introduction of the Kindle in November, 2007. It was well documented to the Court how Amazon used loss-leader discounting of ebooks as an important tool to build that marketplace. The Court is also clearly aware that Amazon is able to support this discounting because of resources stemming from its considerable size and diversity that none of its competitors can match.

But the imbalance I want to call to the court's attention is not about the fact that Amazon sells many things besides books and most of its competitors in the book marketplace do not.

As more and more sales have shifted online and the physical store business has become correspondingly less important, publishers have come to understand that they must develop and maintain direct customer contact with readers. In the print and bookstore era before Facebook and Twitter, this was not necessary, nor was it really possible. Suddenly, it is essential.

Indeed, it is precisely that direct customer contact, developed over 17 years as a retailer, that Amazon uses as a primary tool in its individual title marketing. Indeed, as you know, Amazon is

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now itself a publisher, using direct customer contacts to sell its own titles to consumers. In fact, Amazon's customer database from its retail business (which goes beyond merely its book purchasers, since it sells almost everything) and the communication network it enables are extremely powerful. Using it as their core marketing tool, Amazon is succeeding at signing authors away from major houses even though it can't deliver sales to physical stores, which have largely said they won't stock books coming from their online competitor.

And therein lies the imbalance. The publisher of the future must be able to sell direct. With Amazon as their single biggest wholesale customer, that puts publishers in a Catch-22. If they sell direct at full price, Amazon will undercut them and make them look foolish to their customers. But if publishers discount, they invite a double-whammy. Amazon can still out-discount them, but Amazon (and other retailers) might also insist that the wholesale prices at which Amazon purchases from publishers, which are based on discounts-from-retail, be based on the price the publisher is actually selling for.

So, without a publisher-set price that is honored by everybody, including the publisher, Amazon will effectively be the only general publisher that can sell direct. This will materially disadvantage all publishers in competing with Amazon for authors, and the handicap will become increasingly severe as the sales continue to shift, as they will, away from physical stores and to online purchasing.

In a nutshell, without uniform retail pricing, Amazon can effectively disintermediate the publishers, but the publishers can't effectively disintermediate Amazon.

My second concern relates to the terms of the proposed settlement with three publishers which the Court is being asked to approve. In apparent partial recognition of the dangers of discounting by retailers, particularly the deep-pocketed Amazon, the settlement limits a store's discounting to the total amount of margin it earns from a publisher within a year. As I understand it, that means that if a store were to sell \$10-million of a publisher's books in a year, the store could not discount more than the \$3 million margin (assuming a 30% agency "commission") it would have earned across all the sales it made.

This isn't bad as a principle, and perhaps some variation of it could even address the concern I express about enabling publishers to sell direct. However, translating the principle into action is complicated. It will require reliable data collection, forecasting, and some means of enforcement. I see none of those elements spelled out in the settlement agreement.

At a minimum, it would seem that ebook retailers would have to report actual sales prices of all relevant transactions to the publishers, or have them summarized in a clearly defined and agreed-upon way. This is not data that any retailer, to my knowledge, now shares with its trading partners although, of course, the publishers monitor prices for compliance with publisher-set agency prices.

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But even with the data being provided, when one comes to the last period of the year it will require forecasting and close monitoring to keep track of where things stand in every instance where a retailer is anywhere close to its contractual limit with any publisher.

And, then, what is the penalty if a retailer exceeds its discounting allowance? And who gets compensated? The publisher? Other competing retailers? The other publishers whose sales were compromised by the excessive discounts given to a competitor's ebooks?

In the extremely contentious environment that exists in our business at the moment, I submit that these matters need to be clearly defined in advance if there is any hope for this solution to lead to anything except more litigation.

I very much hope the Department of Justice and the Court will ensure that these points are taken into account before any further binding action is taken, which could have long-term and high disruptive impact on the publishing industry.

Thank you for your consideration.

Sincerely,



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